MORTGAGE SERVICING: AN EXAMINATION OF THE ROLE OF FEDERAL REGULATORS IN SETTLEMENT NEGOTIATIONS AND THE FUTURE OF MORTGAGE SERVICING STANDARDS

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

AND THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

OF THE

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WITNESSES

Thursday, July 7, 2011

APPENDIX

Additional Material Submitted for the Record

MORTGAGE SERVICING: AN EXAMINATION OF THE ROLE OF FEDERAL REGULATORS IN SETTLEMENT NEGOTIATIONS AND THE FUTURE OF MORTGAGE SERVICING STANDARDS

Thursday, July 7, 2011

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
AND SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittees met, pursuant to notice, at 10:03 a.m., in room 2128, Rayburn House Office Building, Hon. Shelley Moore Capito [chairwoman of the Financial Institutions and Consumer Credit Subcommittee] presiding.

Members present from the Subcommittee on Financial Institutions and Consumer Credit: Representatives Capito, Renacci, Royce, Manzullo, Hensarling, McHenry, Pearce, Luetkemeyer, Huizenga, Duffy, Grimm, Canseco, Fincher; Maloney, Ackerman, Hinojosa, Baca, Miller of North Carolina, Scott, and Carney.

Members present from the Subcommittee on Oversight and Investigations: Representatives Neugebauer, Fitzpatrick, Posey, Hayworth; Capuano, Waters, and Himes.

Ex officio present: Representatives Bachus and Frank.

Also present: Representatives Stivers, Schweikert, Garrett; Perlmutter and Green.

Chairwoman CAPITO. This hearing will come to order.

I would like to thank my ranking member, Mrs. Maloney, as well as the chairman of the Oversight and Investigations Subcommittee, Chairman Neugebauer—I am sure he will be here in just a few minutes—and his ranking member, Mr. Capuano, for their cooperation in organizing this joint hearing.

Many Members have expressed a great interest in having a hearing on the topic of mortgage servicing. And it is my hope that today's hearing will provide a forum for Members to cover a multitude of subjects involving mortgage servicing.

We were all shocked to hear the news last fall of allegations that major mortgage servicers had engaged in robo-signing and falsifying documents in order to expedite foreclosures.

Last November, the Housing and Community Opportunity Subcommittee held a hearing on deficiencies in the foreclosure process.

In the months following, Federal regulators have embarked upon an effort to assess the damage caused by these irresponsible actions, determine the need for national servicing standards, and if appropriate, establish penalties for these institutions.

Today's hearing is an opportunity for Members to question regulators that have been at the forefront of these negotiations. As these regulators consider remedies for the problems, it is important that we first identify who has been harmed by the actions of the servicers.

A survey by the regulators of the 2,800 mortgage foreclosure files demonstrated that there were, indeed, weaknesses in the procedures, but failed to show evidence that borrowers had been significantly harmed.

It is my hope that the consent orders agreed to by the agencies and the servicers will provide further clarity about the extent of the harm to borrowers, as well as improved systems.

Some have raised questions about the role of the Consumer Financial Protection Bureau (CFPB) in the ongoing negotiations with servicers and the State attorneys general. Our witnesses from these respective parties can add further clarity on the role that each had played in these negotiations.

Recent news accounts indicate that a monetary settlement is immanent between major servicers and the State attorneys general. I am interested to hear from our witnesses if all State attorneys general are active in these negotiations.

If the settlement is reached, there must be strict oversight as to how the money is distributed and what classifies as harm for borrowers. The proposed settlement between these parties will have a direct impact on servicing standards going forward.

Our second panel will provide information about steps that servicers have already taken to address deficiencies in their systems, as well as the need for national servicing standards.

The input of both industry and consumer representatives is critical in this endeavor. A national servicing standard will have an effect on the mortgage market and we must work together to ensure that new servicing standards, coupled with the proposed qualified residential mortgage standard and other efforts, do not unintentionally impede the recovery of the mortgage market.

I would like to recognize the ranking minority member of the Financial Institutions Subcommittee, the gentlelady from New York, Mrs. Maloney, for the purpose of giving an opening statement.

Mrs. MALONEY. Thank you, Chairwoman Capito and Chairman Neugebauer. And I welcome all of the witnesses today.

Last fall, reports emerged that mortgage servicers were taking shortcuts in processing foreclosure notices and violating the law. Specifically, it was reported that servicers were using inadequate documentation to foreclose some borrowers.

And it was revealed that many servicers were engaging in large scale foreclosures without personal knowledge of the condition of the loan or the borrower's independent financial circumstances.

In addition, we now know that lenders forged signatures and improperly notarized documents in the rush to foreclose on homeowners. These allegations led to a 50-State investigation into the matter of robo-signing and forged signatures.

And just in April, the Federal regulators entered into a consent decree with the largest servicers requiring them to submit their action plans for foreclosure mitigation. I understand they are due tomorrow or this week.

This is a step in the right direction for the industry, and most importantly for the consumers and our overall economy. But rather than holding a hearing about the need for servicing standards and about intervention on behalf of the Federal regulators, many of my colleagues appear more interested in defending the status quo, and suggesting that the States and the Federal regulators stand down.

I thought that no one disputed that things need to change in the servicing industry. Because from where I sit, it is clear that left to their own devices, many servicers have engaged in abusive and unfair behavior and have literally violated the law. And they would have continued to do that if there had not been exposure.

Yet, my colleagues are eliminating Federal programs such as HAMP, which was very successful in helping people renegotiate their loans. But I understand there is a movement that they may extend the HAMP program for a period of time. I hope it is true. And questioning Federal intervention in the industry, the same industry that got us into the mess to begin with.

My friends on the other side of the aisle are essentially criticizing the State AGs for investigating these matters, even though they are investigating potential violations of State law with respect to foreclosure processes and rules.

I had assumed the party of States' rights would support their right to do this, not say their actions are inappropriate. Are they really saying that the servicers shouldn't be held accountable for violating laws of all 50 States and the District of Colombia?

States such as Illinois, California, Utah, and Connecticut are engaging in independent investigations, separate and apart from the settlement negotiations, because they too recognize the need to intervene.

My colleagues are entitled to question things, but they are certainly not entitled to their own facts. And the servicing issue has certainly been a problem in the whole recovery.

For me, the hearing is not about the role of the CFPB during settlement negotiation. It should be about allegations of abuse in the mortgage servicing industry. These abuses are yet one more reason why we need the CFPB and why it has assembled a team that will work on servicing standards once it opens its door on July 21st.

For me, this hearing is about making sure that this type of abuse never happens again. My time has expired. I look forward to your testimony.

Chairwoman CAPITO. Thank you.

I would like to recognize the chairman of the Oversight Subcommittee, Mr. Neugebauer, for the purpose of an opening statement.

Chairman NEUGEBAUER. Yes. Thank you, Chairwoman Capito.

We are holding this important hearing today to better understand the appropriate role of regulators in addressing the failings of some of the Nation's largest mortgage servicing firms.

There is no doubt that documentation, internal controls, and processing were seriously deficient at some of the Nation's servicing firms, and that remedial steps to secure these deficiencies are necessary. As a result, the OCC, the Fed, and the OTS entered into a consent agreement with the servicers to address many of these weaknesses in the mortgage foreclosure process in April of this year.

While I will not comment directly on the regulatory settlement, it is worth noting that prudential regulators led investigations of the mortgage servicers and to remediate deficiencies seems appropriate.

Unfortunately, the State attorneys general and political appointees at the Department of the Treasury and the DOJ are pursuing a separate, more far-reaching settlement. Participation of political appointees, especially that of Elizabeth Warren at the CFPB, an agency with no regulatory or enforcement authority, raises serious concerns about the settlement process.

When political appointees involve themselves in enforcement matters, that may pressure regulatory agencies to advance a particular agenda.

The breadth and the terms of the term sheets presented to the mortgage servicers, which includes a potential $20 billion settlement—we are hearing that could be a $60 billion settlement—for a principal reduction fund, magnifies these concerns that the Administration and some State AGs are attempting to legislate through enforcement.

Speaking more directly, a review of the term sheet brings some words to mind including "coercion" and "extortion."

Even yesterday, the New York Post reported that the principal reduction fund, as I said, could be nearly $60 billion. The settlement proposal requires the resuscitation of policies and programs that have not worked or that Congress has explicitly rejected. For example, the proposed term sheet seeks to revive HAMP, a failed Administration initiative that requires principal write-downs, a policy rejected both in the House and the Senate.

All of this would be funded by the mortgage servicers, with the tab in the tens of billions of dollars.

While restitution for victims specifically harmed by misconduct is completely appropriate, there is no evidence that borrowers have been significantly harmed by the servicers' actions. In fact, the interagency review conducted by the Fed and the OCC found that in all of the 2,800 mortgage files that were examined, the borrowers were seriously delinquent and the servicer had the legal authority to foreclose.

It would be interesting to hear from some of the witnesses as to why a large scale principal write-down fund would be appropriate punishment, especially since there is no evidence that servicer malfeasance caused financial hardship to victims.

Thank you, Chairwoman Capito, for this hearing.

Chairwoman CAPITO. Thank you.

I would like to recognize the ranking member of the full committee, Mr. Frank, for 3 minutes.

Mr. FRANK. First, let us be clear why we are so concerned about this, because there are two reasons. The first is a consideration of fairness for individuals. My colleague has just said that there is no evidence that anyone was harmed by the failure of the servicers to follow the law.

Usually, we hold people to a standard of following the law without a burden of proof on us to show specific harm in specific cases. In fact, the servicers as a group are quite culpable here.

First, many of them were engaged in making loans that shouldn't have been made. And then they compounded that by being inadequately staffed to deal with the problems that arose. I have seen few things done as incompetently as the role of the mortgage servicers. And to exonerate them and say, "no harm, no foul," I think is inappropriate.

I also was surprised to hear my colleague be so critical of political appointees. For Members who are elected to office and run every 2 years to talk about "political" as if that was something bad seems to me quite inconsistent with our mandate.

The notion that political appointees are somehow not to be treated as serious policymakers is not only inaccurate; that is called "democracy." I would say, and this hearing will, of course, make it clear, if people really believe that things should be handled totally non-politically, they should not ask that 535 politicians make the decisions, which is us.

I would also say I was surprised to hear this criticism of the State attorneys general. I shouldn't say I was surprised, because it has been a constant theme in this committee, where there has unfortunately been a party difference on respect for the role of the States. It is a kind of a total reversal.

Conservatives used to talk about States' rights, but there has been a consistent move on the part of many on the other side to diminish and minimize the role of the State. Finally, let's be very clear again that we are doing this not just because of individuals, but the mortgage problem, the combination—and a lot of people were responsible. A lot of people were guilty.

At this point, though, a failure to respond more appropriately is causing great harm economically. And one of the things we need to do to improve the rate of recovery—we are in a recovery, but it is much too slow—is to deal with this problem of the rate of foreclosures.

So I very much look forward to this testimony. But I would reject the notion that somehow it is inappropriate for policymakers, people who have elections and are appointed by people who are elected, including the State attorneys general and high ranking Federal officials, to be involved.

And finally, this continued effort to demonize Elizabeth Warren because she has advised people—not ordered anybody, not insisted—of what to do—is, I think, bizarre.

Chairwoman CAPITO. Thank you.

I would like to recognize the chairman of the full committee, Mr. Bachus, for 2 minutes.

Chairman BACHUS. Thank you, Chairwoman Capito. I have listened to my colleagues on both sides. And there is actually some agreement and some consensus, despite what you may have heard. We all recognize that there have been shortcomings, shortcuts, and shoddy paperwork by some of the mortgage servicing companies.

In fact, Chairman Neugebauer mentioned that the OCC and the Federal Reserve acted to correct these in April. And I think all members of this committee supported that.

Our concern is not the concern that Ranking Member Frank expressed. Our concerns have been the same for the last 2 or 3 years.

And one of those concerns is that the government's efforts in the housing markets have actually—in many cases, they have had mixed results. So let us just say that to be kind, they have been expensive, but they have often been counterproductive.

The HAMP program is a good example, where billions of dollars have been spent to try to prevent foreclosures. The target was 4 million foreclosures. And I think it has come in at about a half a million. And of those, many of them have gone back into foreclosure.

I do think on both sides of the aisle, we agree that we need to work through this backlog of foreclosures. And that is good for all of us. The housing market needs to see a proper level.

In fact, here is what Chairman Bernanke said before our committee about 6 months ago: "I would like to see further efforts to modify loans where appropriate, and where not appropriate." And that is what we are talking about, "where not appropriate." Many times, it is not appropriate.

That is what we worry about with this settlement. People in houses who aren't paying their mortgages, and yet the mortgage companies are not only being stopped from foreclosing on it, but these people continue to be in their homes and not pay their mortgages.

And we don't think it is appropriate for people who are not paying their mortgages or who can't pay their mortgages to receive all the focus. We believe, and I think the American people believe, that their neighbors who are paying their mortgage—the vast amount of Americans who are paying their mortgage or have not gotten into these mortgages.

And we have advocated fairness for these people. Let me close by saying Chairman Bernanke, and I agree with him, he says that, "We need to speed the process of foreclosure and the disposition of foreclosed homes in order to clear the housing market and have a recovery."

That is what we have advocated all along, fairness for those Americans who are paying their mortgage and fairness for those Americans who are attempting to make their mortgage payments, not all the focus and all the money being spent on those who aren't paying their mortgage payments.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

The Minority is going to continue to reserve their time.

Mr. FRANK. May I have 1 minute?

Chairwoman CAPITO. The ranking member is recognized for 1 minute.

Mr. FRANK. First of all, we agree that some mortgages should have to be paid. I have never been supportive of this in every case.

But there are some very worthy cases, including those who are unemployed. And I heard last night and it was mentioned today in USA Today—I guess Secretary Donovan is now having a hearing on it—the Administration is extending, for people who are entitled to do this and are able to deal with it, the foreclosure moratorium for the unemployed and for those in the HAMP program to 12 months.

Some of us have been asking for an extension. There has been a 3-month moratorium.

They are in the process of announcing right now that the moratorium will be extended 12 months. And to take the point of the chairman, that is not for everybody. That will be for some. It would certainly not make sense if there was no chance of people repaying, where you are talking about the unemployed.

But many of us have felt that the 3 months where other criteria were met, where people were appropriately given that kind of forbearance, was not nearly enough time. And I think the 12-month extension will help very much.

Chairman BACHUS. Madam Chairwoman, can I have 1 minute just to respond? And I want to agree with the ranking member.

I do want to say this: there is some good news out there for all of us. One in 20 American families wants to buy a home today. And they have good credit. Our concern is that those families who want to get into mortgages, we don't want the government efforts to prevent them or drive up the cost for them to buy a home.

We want those families who are looking for homes to be able to get into those homes. And we believe that the focus ought to be on them and not on those who can't make payments or do not have proper credit.

I think we can all get there. And I want to commend the regulators. We all acknowledge we were too loose in 2006 and 2007 with our underwriting standards.

But two wrongs don't make a right. And being too tight today or responding inappropriately today with too tight standards or settlements that really don't help those Americans who want to buy a home is counterproductive.

Thank you.

Chairwoman CAPITO. Thank you.

I would like to try to get back in my rhythm here, so I am going to recognize Mr. Fitzpatrick, the vice chair of the Oversight Subcommittee, for 1 minute.

Mr. FITZPATRICK. Thank you, Madam Chairwoman.

For my constituents in the eighth district of Pennsylvania, few issues could be more relevant or important than those that are dealing with the usual foreclosure. Our economic situation is both a symptom and a result of our Nation's housing woes.

So as we work together to repair the damage, improve the economy, and ensure that these failures won't happen again, we cannot forget about those victims who have already been affected.

Foreclosure puts a unique strain on a family. And the damage can linger for years.

This committee and this body have a responsibility to make sure that the mechanisms in place to avoid this catastrophic event are functioning. Mortgage servicers are on the frontline of this battle. Issues with our mortgage finance system aside, servicers are the primary point of contact for most homeowners.

Our constituents' service staff works closely with servicers in an attempt to avoid foreclosure. We count on the servicers to be responsive to our efforts and the regulators to be helpful toward that end.

So, Madam Chairwoman, I look forward to this hearing.

I am hopeful we are going to hear that progress has been made in this area. But more importantly, I want to hear that improvements are going to continue.

I yield back.

Chairwoman CAPITO. Thank you.

I would like to recognize Ms. Waters from California for 1½ minutes to make an opening statement.

Ms. WATERS. Thank you very much, Chairwoman Capito and Chairman Neugebauer, for holding this hearing.

Mortgage servicing was a topic of intense focus for me when I was chairwoman of the Housing and Community Opportunity Subcommittee. And it is good to have a joint hearing on this topic today.

I think it is a little late, but we really do have to deal with this subject.

And while I am pleased to have the opportunity to question our witnesses today, I am a bit perplexed as to why the subcommittee has decided not to invite any servicers to testify. After all, it is their corner-cutting and even fraud that causes us to be in this hearing today. I would really like to hear from them.

Every Member here today has undoubtedly heard from constituents complaining about servicers not telling them the truth on the phone, losing back paperwork, and incorrectly assessing fees, among other improper practices.

So make no mistake, the servicers were allowed to have these botched operations because regulators failed to rein them in, despite continuous pleadings from the advocates.

As a result, this failure to act has now culminated in regulators and State attorneys general trying to make up for lost time by setting up the industry standards and compensating borrowers who have been jerked around, often losing their life savings in the meantime.

While some of my colleagues will no doubt characterize these settlements as some sort of a shakedown, I see it as an attempt to disgorge servicers of wrongful profits accrued through years of running botched, deliberately understaffed operations.

This is in addition to the untold damage done to the securities market in this country by the failure of these banks to properly establish the legal ownership of the mortgages they packaged and sold.

So, thank you very much, Madam Chairwoman.

I look forward to hearing from our regulators.

Chairwoman CAPITO. I thank the gentlewoman.

I would like to make a point of clarification. Both Mrs. Maloney and I felt strongly about having servicers at this hearing as well. They declined because of the pending legal settlement and legal discussions going on, and that is why they are not in attendance at this meeting today.

Ms. WATERS. Thank you very much.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Royce for 1 minute.

Mr. ROYCE. Thank you, Madam Chairwoman.

According to the New York Times, 2 weeks ago, they said in New York State, it would take lenders 62 years at the current pace to repossess the 213,000 houses now in severe default or foreclosure. In New Jersey, they said it would take 49 years.

Economists often argue that a single clearly defined set of rules would be part of the solution to effective regulation and certainly to clearing the market. I think it is no wonder that the housing market continues to sputter.

And I think we add to the problem, given the hodgepodge of statutes and rules, none of which are the same, by the way.

But we have RESPA, TILA, Dodd-Frank, 50 State laws, local ordinances, Federal regulations, State regulations, court rulings, enforcement actions, FHA requirements, VA requirements, and rural housing service requirements. You have the Fannie Mae standards and the Freddie Mac standards.

So, at a minimum, the lack of a single clearly defined set of rules has added to the confusion. It has delayed much of the market from clearing. It has discouraged private capital from coming back into this sector.

Economists are right about this. And we could be part of the solution here if we assist it.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

I would like to recognize the ranking member for the remaining time.

Mrs. MALONEY. Okay. I will use some time and yield some time to the gentleman from Georgia.

I agree with Chairman Bachus that we need to work through this backlog that is flowing in our economy. Economists say housing is roughly 25 percent of our economy. As long as it is there, we are going to have a problem with our economy.

But we need to do it in a fair way. And I don't think anyone on this panel or this room agrees with the robo-signature or moving to evict people from their homes without meeting with them, telling them of a program for possibilities that are there, working with them or even finding out if they have the money in the bank to help move through the process.

So we need to move through it, but in a fair way. And, again, I look forward to the rules and standards that will be coming out tomorrow.

And I yield to the great man from Georgia.

Mr. SCOTT. Thank you very much.

I think I have a few seconds here. But I do want to just share with the committee that I have just come out of working on a major home foreclosure prevention event. And we had phenomenal success.

As many of you may know, Georgia now ranks fourth in the number of home foreclosures in this Nation. In one of my counties—Clayton County—1 out of every 70 homes is in some form of foreclosure.

But we had a very, very effective event in Atlanta, Georgia, about 2 weeks ago. And because we were able to get the information there and get under one roof the loan servicers—which is so important for them to have been here today, but I understand they had some disagreement with their situation and could not.

But let me just say, I take my hat off. We had some outstanding loan servicers there from Bank of America, and Wells Fargo, and Citizens, and Regions Bank, and SunTrust, all major servicers.

We were able to save 2,107 homes in one shot over that weekend, with Treasury's help and HUD's help. And the reason for it was we were able to get the information processed adequately.

This has been one of the major reasons why we have had such a high rate of home foreclosure, because there have been inadequate information on the parts of exchange from the loan servicers.

This has not historically been an area of high profit opportunity for the loan servicers. So they have high turnovers within the people who are providing the service to the homeowner.

A homeowner may call one day, come back, get an answer on his phone, answer it, call back, and there is somebody else handling their case. But when we can sit down with the loan servicers and with the homeowners themselves and make sure that proper information is processed, we can get this problem licked.

I can't begin to tell you. We had line after lines of thousands of people, people in wheelchairs, people on canes, senior citizens, everyone coming at the convention center and leaving with tears in their eyes, so happy that they were able to get their problem addressed.

So there is hope out there. There is success out there.

But we have to get the right information and get the loan servicers to be able to interact properly with the homeowners. And I wanted to share that positive news. We have a ways to go.

And I look forward to this hearing.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. McHenry for 1 minute.

Mr. MCHENRY. Thank you, Chairwoman Capito.

There is no doubt the robo-signing debacle uncovered problems in the mortgage settlement process used by the Nation's largest servicers. But what is clear is that any proceeds of a settlement need to recover losses for those who are actually harmed, and make sure that the management of the foreclosure process has improved.

Instead, it seems certain folks in the position of influence to negotiate this deal are working out of the mentality of "never let a good crisis go to waste."

Judicial Watch recently uncovered extensive involvement by the CFPB, and specifically Ms. Warren, in her attempts to step well outside of her position as an adviser to both the President and the Treasury Secretary, providing a detailed framework for the structure of a settlement and holding "emergency meetings" with State attorneys general.

This is troubling. I find this in-depth involvement very troubling.

I look forward to the rest of the hearing.

Chairwoman CAPITO. Thank you.

Mr. Grimm, for 1 minute?

Mr. GRIMM. Thank you, Chairwoman Capito and Chairman Neugebauer, for holding this hearing.

I appreciate the witnesses' time.

As everyone is aware, the real estate market in the United States remains very, very weak. It makes it very difficult for the economy to experience a strong and robust recovery.

And at the same time, the government is either directly or indirectly underwriting over 90 percent of new home loans in this country. That is a situation that obviously is unsustainable.

So in order for the real estate to recover and to stabilize over the long term, we must get private capital back into the mortgage market. This is the reason the mortgage servicing standard is so important to the future of housing finance.

Investors in new mortgage loans must have confidence that their principal and interest statements will be received in a timely manner and that their positions will be protected in the event that a borrower defaults or of a foreclosure, if it unfortunately occurs.

Without such assurances, I fear that private capital cannot and will not and will continue to be reluctant to return to the mortgage market.

Therefore, again, I thank the witnesses. And I look forward to the rest of this hearing.

Chairwoman CAPITO. Thank you.

Mr. Canseco, for 1 minute?

Mr. CANSECO. Thank you, Madam Chairwoman, and Chairman Neugebauer.

The ongoing foreclosure crisis in this country is one of the largest challenges facing our economy. Since home prices began their decline in 2006, millions of Americans have had their homes foreclosed. And there doesn't seem to be an end in sight for this cycle.

Last fall, some troubling revelations came out about the servicers' industry, an industry which is dealing with an unprecedented amount of workflow due to the crippling housing market.

As with any other government action towards an industry, we, as a Congress, must keep a close watch on the regulatory response to ensure it is targeted and does not make the problem worse.

I have great concern that potential rules prescribed by Federal regulators, rules designed to apply to the largest mortgage servicers, will ultimately impact the smaller servicers who will find the rules too onerous to stay in the servicing business.

I am also concerned that the purported State attorney general settlement with the largest servicers could open the door to perverse incentives that could make the foreclosure problem worse.

With this in mind, I look forward to your testimony. Thank you.

Chairwoman CAPITO. Mr. Fincher, for 1 minute?

Mr. FINCHER. Thank you, Madam Chairwoman.

When the mortgage crisis hit our economy a few years ago, it left many homeowners questioning their American dream. Their mortgages were now more than their homes were worth. Many homeowners looked to their lenders, to State governments, and to Washington to find the answers.

Our number one priority should be not to cripple our financial institutions, but to find the happy medium to prevent another mortgage crisis while ensuring that the approach taken will not impede our economic recovery.

We don't want to fall into the trap, as Chairman Bachus said a few minutes ago, of overreaching and unintended consequences.

So I thank the witnesses for coming, and I look forward to your testimony.

I yield back.

Chairwoman CAPITO. Thank you.

That concludes our opening statements. I would like to introduce our first panel of witnesses for the purpose of giving a 5-minute opening statement.

I would like to yield to the chairman of the full committee. He would like to introduce his witness really quickly and then—

Chairman BACHUS. Thank you.

It is my pleasure to introduce a good friend of mine, Luther Strange, who is the new attorney general in Alabama. General Strange was named one of the South's leading economic development attorneys prior to being elected to his position as attorney general.

I have read his testimony before this committee. And I think he offers an awful lot.

He is committed to consumer protection. He is also committed to a strong economy and to seeing that our Nation recovers.

I think what he has laid out—and he has some strong reservations about the settlement that he is being led into, that it may have some unintended consequences.

Luther and Melissa, his wife, have two sons. And Luther is normally the tallest guy in the room. He was the starting center at Tulane University. But he is actually maybe the third tallest person in the room today because I see Luke and Kane, his two sons.

Luke works for Joe Bonner, one of our colleagues. And Kane works for Senator Sessions. And they are the two guys who are just as tall as Luther back there, sticking way up in the audience.

So you have a cheering section, Luther. We welcome you. It is really a pleasure to have you. And you are doing a fine job as attorney general.

Your testimony is very insightful. Thank you.

Chairwoman CAPITO. Thank you.

I would first like to recognize Ms. Julie Williams, First Senior Deputy Comptroller and Chief Counsel, Office of the Comptroller of the Currency.

Welcome.

STATEMENT OF JULIE L. WILLIAMS, FIRST SENIOR DEPUTY COMPTROLLER AND CHIEF COUNSEL, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Ms. WILLIAMS. Thank you. Chairwoman Capito, Chairman Neugebauer, Ranking Member Maloney, Ranking Member Capuano, and members of the subcommittee, I appreciate the opportunity to appear this morning on behalf of the OCC to discuss issues related to mortgage servicing.

My testimony focuses on three areas. First, my written statement describes the examinations by the OCC and the other Federal banking agencies of defects in foreclosure processes at the 14 largest federally-regulated mortgage servicers.

Although these examinations found that the loans in the sample examined were seriously delinquent, the exams also found serious deficiencies of different degrees at each of these servicers in the areas of foreclosure governance, foreclosure document preparation, and the oversight of third-party service providers.

These deficiencies constitute unsafe and unsound banking practices. To address them, the OCC and the other banking agencies issued cease-and-desist orders.

The sample of foreclosures reviewed in the exams exposed serious flaws in the banks' foreclosure processes. But as a sample it could not, of course, quantify the individual borrowers who might have suffered financial harm due to these defects.

That is why the orders issued by the agencies require a comprehensive and independent review of foreclosure actions during a 2-year look-back period.

The independent review will seek to identify financially harmed borrowers who had a pending or completed foreclosure in 2009 or 2010 through two distinct means: one, notice and outreach to those borrowers of their right to file a complaint, and to have that complaint reviewed by an independent consultant; and two, targeted review of the loans of borrowers who are in identifiable high-risk segments, which will provide an additional opportunity to detect borrowers who suffered financial harm.

The orders require that the servicers submit detailed action plans to revamp major aspects of their mortgage servicing and foreclosure operation. For example, action plans are required to implement comprehensive revisions of mortgage servicing, loan modification, and foreclosure processes.

The orders also address the elimination of dual tracking and require the establishment of a single point of contact system, to ensure that borrowers can contact a live person throughout the process.

The second portion of my written statement discusses the relationship between the implementation of our enforcement orders and the separate negotiations that are being conducted by other authorities. Most notably, the Department of Justice is coordinating settlement discussions involving DOJ, a group of other Federal agencies, and State attorneys general.

The scope of these discussions includes issues outside the scope of our orders, but it also includes areas of mortgage servicing and foreclosure procedures that overlap with the scope of action plans that are required under our orders.

Other initiatives also are under way that will affect mortgage servicing standards. In particular, the newly announced GSE delinquency management and default prevention standards will have a substantial effect on servicing practices, since those standards, for the foreseeable future, will govern an overwhelming portion of the mortgage market.

These different initiatives will subject servicers to more rigorous standards and provide borrowers greater protection. But they also raise the prospect of multiple and potentially inconsistent standards.

We have strongly urged the value of achieving a common set of standards, whereby servicers can satisfy not only the terms of any settlement agreements but other applicable requirements as well, such as the GSE standards.

In order to help achieve this result, in consultation with DOJ, we have adjusted the deadline for servicers' submission of various action plans that are required under our order to facilitate synchronization with the DOJ-led settlement effort.

In the final portion of my testimony, I discussed the current interagency effort to develop comprehensive and uniform servicing standards. The goal here is to establish rigorous, uniform standards for responsible servicer conduct that reach beyond the servicers covered by the current enforcement action.

It will be critically important to ensure that any standards that are adopted apply to and are implemented by all firms engaged in mortgage servicing, not just the federally-regulated depository institutions, and that there is strong oversight of all servicers' compliance.

I appreciate the opportunity to appear before the subcommittees this morning to discuss these important topics. And I look forward to answering your questions.

Thank you.

[The prepared statement of Ms. Williams can be found on page 128 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. Mark Pearce, Director, Division of Depositor and Consumer Protection, FDIC.

Welcome.

STATEMENT OF MARK PEARCE, DIRECTOR, DIVISION OF DEPOSITOR AND CONSUMER PROTECTION, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. PEARCE. Great. Thank you, Chairwoman Capito, Chairman Neugebauer, Ranking Members Maloney and Capuano, and members of the subcommittee.

Thank you for the opportunity to testify today on behalf of the FDIC about the ongoing need to address and resolve challenges in mortgage servicing.

The issues involved continue to impact our housing market, borrowers, and communities across the Nation. As you know, the FDIC is not the primary Federal regulator of the largest financial institutions and mortgage servicers, where major servicing and foreclosure deficiencies have been found.

Nevertheless, as the insurer of deposits of these institutions, we remained concerned about the potential ramification of these deficiencies, not only on these institutions, but on the housing and mortgage markets overall.

Last fall, in the wake of allegations of robo-signing, the primary Federal regulators invited the FDIC to participate in interagency review of the foreclosure practices of 14 of the largest mortgage servicers. These reviewers identified significant deficiencies in the foreclosure processes of all 14 institutions.

These deficiencies included the filing of inaccurate affidavit and other documentation in foreclosure proceedings, inadequate oversight of attorneys and other third parties involved in the process, inadequate staffing and training of employees, and the failure to effectively coordinate the loan modification and foreclosure process to ensure effective communications with borrowers seeking to avoid foreclosures.

In April of this year, the primary Federal regulators took an important first step in addressing the deficiencies by issuing enforcement orders related to foreclosure practices by these largest mortgage servicers.

The FDIC is hopeful these orders will put services on a path to having the staffing, management and operational control necessary to work effectively with homeowners to fairly and efficiently resolve mortgage defaults. To do so, regulators will need to closely monitor the servicers to ensure the orders are implemented as they are intended to be.

In particular, the review of past foreclosures must be able to convince the skeptical public that homeowners harmed by servicer errors have been identified and compensated, as promised by the primary Federal regulators.

Even if implemented fully, the consent orders are only a partial resolution to mortgage servicing deficiencies. The interagency review of foreclosure practices did not purport to examine loan modification practices or other potential errors in mortgage servicing.

As such, the FDIC supports the Federal-State collaboration between the Department of Justice, other Federal agencies, and the State attorneys general to address a broader range of issues regarding the servicing process.

A comprehensive resolution for past servicing errors is essential to the recovery of the housing market and the greater economy. Past servicer errors had given rise to a multitude of actual and potential claims from litigation, placing a cloud of uncertainty over recent foreclosures and transfers of title.

Market anxiety regarding the ownership rights and the obligation of borrowers and investors dampens expectations regarding the housing market's recovery and discourages the return of private capital to the mortgage market.

Accordingly, the FDIC has encouraged the Financial Stability Oversight Council to continue its efforts in examining the potential financial systemic risks surrounding mortgage servicing and foreclosures.

Furthermore, until servicers improve their practices and processes, some current homeowners will miss the opportunities to avoid foreclosure, while others will be able to delay the inevitable. Given the continuing fragility of the housing market, effective servicing is as important as ever.

In conclusion, the mortgage servicing system over the past few years has ill served all parties involved—borrowers, neighborhoods, and investors—and has impaired the health and the recovery of the housing and mortgage markets.

Market reforms are needed to align the incentives for effective servicing.

In addition, the FDIC will continue to work with our Federal colleagues to develop sensible and balanced servicing standards, tempered by the knowledge that community banks have not demonstrated the type of deficiencies and errors present in the largest institutions.

Thank you for the opportunity to testify on these issues before you today. I look forward to responding to your questions.

[The prepared statement of Mr. Pearce can be found on page 95 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. Raj Date. He is the Associate Director of Research, Markets, and Regulations at the Consumer Financial Protection Bureau, U.S. Department of the Treasury.

Welcome.

STATEMENT OF RAJ DATE, ASSOCIATE DIRECTOR FOR RESEARCH, MARKETS, AND REGULATIONS, CONSUMER FINANCIAL PROTECTION BUREAU, U.S. DEPARTMENT OF THE TREASURY

Mr. DATE. Thank you.

Chairwoman Capito, Chairman Neugebauer, Ranking Members Maloney and Capuano, thanks for inviting me to testify today about mortgage servicing.

My name is Raj Date. I serve as the Associate Director for Research, Markets, and Regulations at the CFPB.

Our mission at the CFPB is clear: to make consumer finance markets work for the American people. That means ensuring that consumers have the information they need to make financial decisions that are right for them.

It means promoting fairness and transparency and competition in consumer finance. It means setting and enforcing clear, consistent rules that allow banks and other firms to compete on a level playing field.

The Bureau is not yet open for business. But 2 weeks from today, on July 21st, pursuant to last year's Dodd-Frank Act, the Bureau will receive transferred authority from seven existing regulators to administer Federal consumer financial protection laws.

And on that day, I am happy to report we will be—

Chairwoman CAPITO. Excuse me, Mr. Date. Could you move the microphone a little closer?

Mr. DATE. Certainly.

Chairwoman CAPITO. Thank you.

Mr. DATE. On July 21st, I am happy to say that the Bureau will be ready. And on that day, mortgage servicing will be one of the CFPB's priorities.

That is because mortgage servicing is important. It is an enormous market, with some $10.4 trillion of unpaid principal balances.

It is, moreover, marked by two structural features that make it unlikely that market forces alone can suffice to protect consumers.

The first of those structural features is simple. In the vast majority of cases, consumers can't actually choose their mortgage servicers, at least not over time.

Let me introduce the importance of that, just as an example. Last week, I had the occasion to go to a drugstore. If my pharmacist had made me stand in a long line, or if she was rude, or if she was losing my paperwork, or if she was impossible to find on the phone, or if she gave me guidance that was wrong, I would just go to a different pharmacist next time.

That is how most consumer-facing markets work.

I get to choose my drugstore. I typically don't get to choose my mortgage servicer, at least not over time.

The second structural feature of mortgage servicing that relates to consumer protection is that under the current system of servicer compensation, taking on the servicing of a mortgage resembles a bet on credit.

If a loan remains performing, then servicing the loan remains profitable. But if the borrower becomes delinquent, then the cost of properly servicing the loan is likely to be greater and perhaps substantially greater than the revenue from servicing that loan.

If a servicer's portfolio, therefore, contains many more non-performing loans than the servicer expected, the servicer tends to lose money.

Faced with that unfortunate financial reality, when they encountered an upswing in mortgage delinquencies, servicers apparently started cutting corners. Rather than making necessary investments in capacity, they have loosened operational protocols, even to the point of violating State and Federal laws.

The evidence of this is striking. In the examinations of 14 major servicers this spring, the Fed, the OCC, and the OTS discovered critical weaknesses in governance, in foreclosure processing, and in vendor management.

They discovered unsafe and unsound practices. They found violations of State and Federal law. They discovered these weaknesses and deficiencies in all 14 of the 14 servicers examined, together accounting for more than ⅔ of the entire mortgage market.

In the Dodd-Frank Act, Congress took important steps that will correct flaws in Federal regulation of mortgage servicing, in particular the lack of comprehensive Federal standards for mortgage servicers and the lack of direct full Federal oversight over independent non-depository servicers.

The CFPB, when it has its full authority, will have the tools to address both of those problems.

And to make sure that we deeply understand the markets we will be regulating, our team has already been in contact with a range of stakeholders, community banks, credit unions, big banks, consumer groups, academics, and many others.

But while the CFPB can and will address consumer protection, a comprehensive approach that also protects investors, the financial sector and the economy and the housing market as a whole requires the coordinated action of a larger group of Federal agencies, including the prudential regulators.

The Bureau will be working together with those agencies to the maximum extent possible. Because, after all, both consumers and the industry will benefit when regulatory action is careful, and it is coordinated, and it is coherent.

Two weeks from now, the Bureau will be ready to start helping make the consumer finance markets work for the American people. And I am confident that the result of our efforts, coordinated with those of the other agencies, should make the servicing market work better for everyone.

Thank you for the opportunity to testify.

[The prepared statement of Mr. Date can be found on page 86 of the appendix.]

Chairwoman CAPITO. Thank you.

Our final witness on this panel has already been introduced by Chairman Bachus, but he is the Honorable Luther Strange, Attorney General of the State of Alabama.

Welcome.

STATEMENT OF THE HONORABLE LUTHER STRANGE, ALABAMA ATTORNEY GENERAL

Mr. STRANGE. Thank you very much, Chairmen Capito and Neugebauer, Ranking Members Maloney and Capuano, and members of the subcommittee, and my Congressman, Chairman Bachus.

My name is Luther Strange, and I am the attorney general of the State of Alabama. Thank you for inviting me to testify today on the ongoing settlement negotiations with the mortgage servicing companies.

In October of 2010, the Alabama Attorney Generals Office joined 49 other State attorneys general to form the so-called Foreclosure Multi-State Working Group. The purpose of the group is to investigate allegations that mortgage companies mishandled documents and violated laws when they foreclosed on homeowners across the United States.

Like 26 other States, Alabama is a non-judicial foreclosure State. The other States have elected through their legislatures to adopt the judicial foreclosure process.

In March of this year, the Working Group submitted a term sheet to the Nation's largest mortgage servicers, which was presented as a draft agreement on behalf of attorneys general and other State and Federal agencies. And it was intended to settle allegations related to improper foreclosure practices and loan servicing.

The servicers have responded to the term sheet. And negotiations are currently under way between the States, the Federal Government, and the mortgage servicers.

As I, as an attorney general, review any potential settlement agreement, I am guided by three overarching principles.

First, the settlement must hold the mortgage servicers accountable for unlawful and deceptive practices under State law. Second, attorneys general are not responsible for legislating and setting policy. And the settlement agreement should not attempt to overreach into the area of State and Federal policy decisions.

Third, the settlement must contain provisions that discourage and deter future illegal activity. Above all else, unethical mortgage servicers and any other bad actors in the mortgage servicing industry must be held accountable for any unlawful or deceptive practices they engaged in.

Certain aspects of the term sheet, such as those dealing with single point of contact, dual-track foreclosures, robo-signing, and verification of account information, contain many changes in practice that are beneficial to consumers. Enforcement agencies and the entire industry should have a vigorous debate on these proposals.

My staff and I take our duty to protect consumers seriously. And we will work to investigate and prosecute bad actors to the fullest extent of the law.

Any fines or penalties assessed on the servicers, pursuant to a settlement agreement, should be linked, in my opinion, in response to specific documented violations of State and Federal law.

Protecting consumers, like many other goals of the Foreclosure Multi-State Working Group, is not only laudable, it is something that I consider my highest duty.

But I am concerned that what started out as an effort to correct specific practices harmful to consumers has evolved into an attempt to establish an overarching regulatory scheme that fundamentally restructures the mortgage loan industry in the United States, an effort which is well beyond the scope of responsibility of attorneys general.

Here are just a few specific concerns that I have. First, any ultimate settlement must not preempt State law sovereignty. Alabama, like the majority of other States, has made the policy decision to permit non-judicial foreclosures.

I am skeptical of any agreement that essentially makes all States subject to the judicial foreclosure process without a legislative mandate.

Second, mandated principal reduction is bad public policy and creates questions of fundamental fairness and justice. Mandated principal write-down would create an incentive for homeowners to default and seek a reduction of principal.

Requiring lenders to reduce mortgage balances would remove incentives for banks to lend money and for investors to purchase mortgages, denying people access to the credit they need to purchase a home.

Third, a settlement must not impair an efficient foreclosure process that clears local markets and facilitates economic recovery. I am very skeptical of any settlement that forces servicers to violate contracts with mortgage owners and abrogates the rights of second lien holders.

Finally, a settlement must not impose onerous regulatory burdens on community banks. In my State of Alabama, we have over 130 community banks that are an important economic driver in the State.

We must not increase their regulatory burden when it is clear they generally were not engaged in the conduct giving rise to the investigation.

Thank you again for holding this important hearing. And I look forward to answering your questions.

[The prepared statement of Mr. Strange can be found on page 123 of the appendix.]

Chairwoman CAPITO. Thank you. Thank you all.

And I would like to begin questioning.

Ms. Williams, one of the concerns that I have, and I think it has already come to light as we have had before or before in testimony, is we have the OCC over here, developing a standard.

You mentioned in your statement that the GSEs had looked at a servicing standards. The State attorneys general want to make sure that there are no State preemptions, so they have servicing standards.

Who is going to enforce all this? And what kind of singular standards—in my view, if we are going to move in this direction, a singular standard would certainly be better in terms of how the servicers meet those demands, but also in terms of the service provided to consumers.

Could you comment on that?

Ms. WILLIAMS. Certainly. As I indicated, a concern that we have with the processes under way right now is whether there will be, at the end of the day, multiple and potentially inconsistent sets of standards.

And so we very strongly urge the effort to try to come together, at least on core principles and core elements of the servicing standards that are going to be the components of the different enforcement result here.

And that would also, we think, carry over to the discussions that are on going at the banking agencies, the CFPB and FHFA, for example, with respect to developing uniform, consistent national standards that would apply to all servicers.

So, I think the enforcement processes, in other words, will identify a body of core standards and some detail under those standards that hopefully will translate into significant portions of uniform standards that the agencies can adopt going forward.

There are potentially different enforcers involved for the different entities subject to the standards, at the end of the day.

Chairwoman CAPITO. I thank you for that.

And I think you highlight properly that there can be some serious issues involved with trying to figure this all out, and deliver the best service, and stop some of the practices that have gone forward.

The other thing I would like to ask about is the principal reduction. And I would like to ask all of you all this question briefly.

The State attorney general, Mr. Strange, has already mentioned that he doesn't think this should be mandated. Principal reduction should not be part of a national servicing standard.

Is this something that you are recommending?

I will start with you, Mr. Date. What does the CFPB think about that?

Mr. DATE. Thank you, Chairwoman Capito.

The way in which I try to think about the notion of principal reduction is within the broader context of loss mitigation within mortgages, which is, after all, largely speaking, a non-recourse secured lending market.

In that kind of market, there is always a potential for moral hazard. And indeed, most of the loss mitigation techniques that are employed by servicers today in the marketplace involve some manner, appropriately, of economic concessions to a borrower in order to try to keep that borrower current.

Principal reduction is one of those manners of economic concessions, and one that could very well, and indeed today does for some servicers play a part in the overall loss mitigation arsenal.

Chairwoman CAPITO. So what you are saying is that it might be one of the tools in the toolbox, but it wouldn't be a requirement of a national servicing agreement?

I think just a quick "yes or no" because I am running out of time here.

Mr. DATE. National servicing standards may or may not address any particular loss mitigation techniques. But I know that the interagency group is working hard to frame the issues and at least think about what those—

Chairwoman CAPITO. Are you aware if this is already included in the settlement agreement that is being worked with the State attorneys general?

Mr. DATE. I am not specifically aware; I am not involved in the day-to-day conversations with mortgage servicers. That clearly is a process being led by the Department of Justice and State attorneys general.

Chairwoman CAPITO. Thank you.

Mr. Pearce, did you have a quick comment on that?

Mr. PEARCE. Yes. I think the way servicers look at whether to do a loan modification is to figure out whether doing a modification of some kind is better than the alternative of going to foreclosure and losing a significant portion of money there.

And so I would agree—

Chairwoman CAPITO. I guess I am asking for the mandatory issue.

Mr. PEARCE. Right.

Chairwoman CAPITO. Do you think it should be a mandatory part of a national servicing standard?

Mr. PEARCE. Right. I think the attorneys general and the Department of Justice are really working out whatever voluntary agreement they can come to with the largest servicers on that. And so, I can't really speak to where they are in that process.

But I don't think that sort of a mandatory process is something that—certainly the FDIC hasn't talked about, that people should make principal reductions when they don't make economic sense.

Chairwoman CAPITO. Right. Thank you.

Mrs. Maloney?

Mrs. MALONEY. For the overall economy, the large number of defaults, the losses, the servicer challengers are really putting up a barrier that could delay a broader recovery of our economy.

So moving forward and getting this solved is critical. And I would like to Attorney General Strange and then Mr. Date and down the line about the servicing process.

In New York, we had some of the highest numbers of subprime loans. But under the leadership of our Governor, we organized regional meetings with other elected officials, and banks and not-for-profits voluntarily participated. And we one-on-one worked out details that helped people stay in their homes.

So, I would like to ask you, do you think that servicers have done a good job of communicating to borrowers about their loss mitigation policies and about their rights and options once they have gone into default?

If not, what improvements need to be made? And what is the best mechanism to ensure that we have this improvement?

Starting with Mr. Strange, then Mr. Date, and down the line.

Mr. STRANGE. We have a consumer protection unit in our Office of the Attorney General. And we have received a number of complaints.

We deal with those on an individual basis. I wouldn't say it is a crisis situation in Alabama. But we have State laws that deal with it.

And I believe they work well. That is the decision we have gone with. As I mentioned, the non-judicial foreclosure process, which contains a number of protection for consumers.

So, we are very diligent in making sure that those procedures are followed. And I think it is working fairly well in our State.

Mrs. MALONEY. Mr. Date?

Mr. DATE. Thank you.

Mortgage servicing, because of its size and the relative diversity of the participants in it, naturally has a range of players in terms of how good they are, frankly, at some of the harder pieces of the business.

Loss mitigation in particular and making sure that there is a high touch customer context during delinquency is a difficult skill. And there is no doubt in my mind that some firms happen to be quite better at it than others.

The question of whether or not, therefore, there should be some manner of baseline expectation is exactly the kind of question that I would love to be addressed in this interagency dialogue on national mortgage servicing standards. It is precisely that kind of question.

Mrs. MALONEY. What do you think would be the baseline? Obviously, what we saw in the past was robo-signatures, moving to evict people from their homes without even meeting with them or telling them their options, or even looking at their bank accounts to see whether or not they could work it out.

What kind of baseline would you suggest would be appropriate?

Mr. DATE. There is, obviously, the most rudimentary baseline, which is abiding by current Federal and State law. Despite, for example, the diversity in the standards across the various States and as promulgated by, for example, by the GSEs or FHA, the fact of the matter is there is no State in which falsely notarizing an affidavit is an acceptable thing to do.

So there is that baseline. But, unfortunately, that baseline comes down to effective supervision and effective enforcement over time.

With respect to mortgage servicing standards, more broadly, there are certainly mechanisms that one can use at a trigger point, in terms of number of days of delinquency, where if you are going to proceed, for example, to foreclosure, some other steps should have taken place.

One form of that is restraints on so-called dual track processing.

Mrs. MALONEY. Thank you. Mr. Pearce?

Mr. PEARCE. Certainly, in our participation, in our agency review, we found significant efficiencies throughout the foreclosure process to ease around staffing and training. And that is in my testimony.

And I think one of the things that Mr. Date raises is that there are different departments in mortgage servicers. The larger mortgage servicers don't always communicate very well with each other. And that can present some real challenges for borrowers.

That is why the FDIC has strongly supported the idea of having a single point of contact, to have a real individual person there who can answer a borrower's questions, regardless of whether they are in the process of foreclosure or in the process of a loan modification.

We think that would really add a lot to making this process work smoother, in addition to the improvements in staffing and training.

Ms. WILLIAMS. I think you are asking a question that has a couple of dimensions: one, how the borrowers are dealt with in their interactions with the servicers; and two, the outreach to the borrower in working out the problems that they have with their mortgagers.

I think what we have seen over the course of the last couple of years is that the servicers got a slow start in both respects. They have done a lot to improve on the outreach part in the initiatives they have undertaken in themselves and in the way that they partner with local, regional and national community organizations in those sort of events that Congressman Scott described.

And there have been significant improvements in the way that they have dealt in their internal operations with customers, the single point of contact being one example.

In the complaints process that we envisioned in our orders to have the servicers reach out to borrowers who were in any stage of the foreclosure process during specified time periods, we are going to be requiring even more aggressive outreach in that process.

Chairwoman CAPITO. Thank you.

The gentlelady's time has expired.

I would like to recognize Chairman Neugebauer for 5 minutes for questions.

Chairman NEUGEBAUER. Yes. Thank you, Madam Chairwoman.

Just to restate, I think everybody agrees that if the mortgage servicers violated the law and didn't have good policies, that you have taken the appropriate action. And nobody is faulting that.

We also need to understand, though, that these servicers, in many cases, did not originate these loans. And so, in many cases, we have to careful of what we are punishing them for.

Are we punishing them for poor servicing? Or are we trying to punish them for some mistakes that were made up the food chain?

What I am most concerned about, though, is clear evidence that this Administration has been trying to install into this settlement agreement policies that this Congress has rejected. And that is the point that I want to cover this morning.

And, Mr. Date, if you recall, Chairwoman Capito and myself and others wrote Secretary Geithner to express our concern about Ms. Warren's involvement in promoting the State attorneys general settlement.

The response we got back was that the request was basically limited to advice. Yet, when we received documents that were produced to this committee Tuesday night, those documents showed that Ms. Warren actually took a leadership role in the settlement talks.

For example, emails showed that the CFPB convened an emergency meeting with certain attorneys general to push settlement solutions that focus on principal reduction modifications. Would you agree that activity constitutes a little bit more than advice?

Mr. DATE. Thank you for the question.

With respect to the request that was made to the Treasury Department and to Professor Warren, with respect to her participation or the Bureau's participation in the mortgage servicing settlement conversation, I do feel that the response has been unambiguous over time.

And I suppose that, for my own part, I would reiterate it again today. We have been asked by the Secretary of the Treasury to provide advice to those Federal and State agencies involved in this matter.

We tried to do that. And in doing so, we were active and I hope engaged participants in that dialogue. That, I believe, was the response at that time, Mr. Chairman. And I believe it is my response now.

Chairman NEUGEBAUER. I don't think it is just this one event here. We can look at a series of emails between Ms. Warren, yourself, and U.S. Bank CEO Richard Davis, documenting meetings held on March 10, 2011, and March 11, 2011.

What was the nature of these meetings? And was anything about the settlement discussed in those meetings?

Mr. DATE. Mr. Davis, as you say, is the CEO of U.S. Bank. And we have had the opportunity to talk on several occasions in the past about a variety of issues. The nature of my role in particular is to lead the division that is called Research, Markets and Regulations.

And, indeed, my intent and our division's intent is to make sure that what we do from a policy point of view is simultaneously grounded in empirical analysis, on the one hand, and a deep grounding in the pragmatism of what actually happens in the marketplace.

To my recollection, any conversations with Mr. Davis and/or his team has been with that in mind. And in particular, in the meeting that you are discussing, I recall Professor Warren actually prefacing that meeting with an explicit statement that what that meeting was about is about the market broadly and not—

Chairman NEUGEBAUER. Let me just refresh your memory a little bit. In that email, it describes this needs test to determine the eligibility for principal reductions in loan modifications.

So, this loan modification discussion has been evidently going on for a long period of time.

And, in fact, I think in one of those emails, Mr. Davis said—it goes into detail of this presentation that he has and discussions that you all had on determining who is going to get loan modifications.

Mr. DATE. Without talking about anything in particular as it relates to U.S. Bank, I would be happy to talk about the nature of that conversation with Mr. Davis. It is broadly known that the institution acquired through the FDIC institutions with what I would characterize as a deeply-troubled mortgage portfolio.

They, like other mortgage participants, have thought about the range of loss mitigation devices to use therein. Loss mitigations are a form of economic concession. And if you don't carefully think about how they are offered, it can trigger moral hazard which, of course, as any kind of non-recourse secured lender, you want to avoid.

Chairman NEUGEBAUER. Yes.

Mr. DATE. He was talking about one of the means by which that is done.

Chairman NEUGEBAUER. My time has expired. But I think that you have done a great job of avoiding answering the question.

The truth is that the CFPB has been extremely involved in these negotiations. And there is other email traffic here with other CEOs where they are wanting to know, can we meet off the record, because we are concerned about what we are reading in the paper.

And so, I think that is the troubling part of what we see going on here, is the fact that this agency, which you say on July 21st which has no Director, by the way. And a lot of us question whether your agency can actually be up and running on—

Chairwoman CAPITO. The gentleman's time has expired.

Chairman NEUGEBAUER. —July 21st or not, because of the fact that you don't have an acting Director or the Director has not been nominated and confirmed by the Senate.

But I think it is troubling that we find the extent of the involvement, be it banal, by the CFPB of really having much input—

Chairwoman CAPITO. The gentleman's time has expired.

I would like to recognize Mr. Capuano for 5 minutes.

Before I do that, I would like to ask unanimous consent to enter into the record a statement from the Board of Governors of the Federal Reserve System, and also a statement from the National Association of REALTORS®.

Without objection, it is so ordered.

Mr. Capuano?

Mr. CAPUANO. Thank you, Madam Chairwoman.

Mr. Attorney General, I think you raised some interesting points. I just need some clarification.

You or your predecessor—I assume it was you—voluntarily joined this lawsuit?

Mr. STRANGE. That was my predecessor.

Mr. CAPUANO. Your predecessor, voluntarily. He wasn't required by any law, so he voluntarily joined. And for any settlement, is there a way for you to step back and say, "Look, we were glad to be a part of it up until now, but we don't want to participate."

Mr. STRANGE. Yes.

Mr. CAPUANO. So anything that is agreed to by, for the sake of discussion, 49 others or 5 others, you do not have to participate in it?

Mr. STRANGE. That is correct. Yes, sir.

Mr. CAPUANO. That is a fair point. Thank you.

That is important because I think some of the points you raised are important and particularly when they are important to you. I totally agree on the sovereignty issue. No one should require any State to take action that they don't want to take.

So, I think you just answered that question for me satisfactorily.

When you have been involved with other cases like this, or even in this case itself, in the final analysis, how do 50 States or 10 States, or whatever the number is going to be, how do you finally come to an agreement at the end?

Do you vote on it? Or is it a general consensus? How is it generally done?

Mr. STRANGE. I am relatively new to this, since I was not sworn in until January of this year. So I sort of inherited this.

Mr. CAPUANO. Okay.

Mr. STRANGE. And so, as I have weighed into it, I couldn't speak to the history of these things that are done. This particular case is being led by Attorney General Miller from Iowa, who has been extremely active in these types of things for many, many years.

So, I am sort of learning about it. That is why I am really speaking in terms of principal—

Mr. CAPUANO. In the end, though, the attorneys general who are left at the table, the ones who have not walked away will have a say in the final decision. Is that accurate?

Mr. STRANGE. The way this is structured is with a sort of a working group within the AGs. So I think there are maybe seven or eight AGs who are actively involved. I have not personally been involved in—

Mr. CAPUANO. But no one from the outside can force you to come to a decision. Is that a fair assessment?

Mr. STRANGE. Yes, sir.

Mr. CAPUANO. And that includes the CFPB?

Mr. STRANGE. I don't think anyone can force the attorney general to do anything.

Mr. CAPUANO. That is my understanding. When you have done other—before the attorney general, were you involved in these kinds of matters?

Mr. STRANGE. I did a lot of different types of corporate business transactions over the years.

Mr. CAPUANO. And when you were involved in things like this in the past, would you ordinarily reach out to people who may not be participants for their expertise, for their input, for their advice?

Mr. STRANGE. In my experience, I was typically dealing with parties and negotiated arrangements. There were two parties with direct involvement in the situation.

So I really don't have a lot of experience in dealing with these sort of global policy matters.

Mr. CAPUANO. That is a fair answer.

I would like to ask Ms. Williams or others, you have been involved in similar things? Is it ordinary for people to reach out either to you or for you to reach out to other people who might have expertise and knowledge in an area that you don't?

Ms. WILLIAMS. My experience is in the interagency process with the banking agencies. And so, I don't know if that parallels the experiences of having a 50-AG negotiating group.

Within the OCC, we reach out to experts within the different departments to provide support.

Mr. CAPUANO. Yes.

Mr. Pearce, at the FDIC, have others reached out to you when you were a party to a suit? Or have you reached out to others to find expertise that you may not have available?

Mr. PEARCE. Sure. I think especially, as Ms. Williams' points out in her testimony, we are trying to align these things up as much as possible. And so having interagency consultations is a key part of that process to understand.

Mr. CAPUANO. Fair enough.

And I believe it was you, Ms. Williams. I would like to clarify.

Is it fair to say that everybody should have a general interest, not to give up any rights or abilities, but a general interest in coordinated oversight and regulation of the financial services industry?

Has anybody ever heard of anybody who is interested in having a discoordinated oversight and regulation, to make sure that every bank, every financial service agency has 20 different regulators? They have not even talked to each other.

Has anyone on the panel ever heard anybody advocate that position?

I didn't think so, because we all want coordinated oversight. Is there anyone here who disagrees that Mr. Date's comment that on July 21st, the CFPB, whether you like it or not—that the CFPB will take over a significant amount of the regulatory oversight of this particular aspect of the financial services industry?

Does anybody disagree with that statement?

Ms. WILLIAMS. Congressman, one thing that I would clarify here is the transfers that occur on July the 21st do not transfer the safety and soundness authorities of the banking agencies.

Mr. CAPUANO. I understand that. But do you disagree that a significant portion of the oversight of this industry will be transferred to the CFPB on July 21st?

Ms. WILLIAMS. That is correct.

Mr. CAPUANO. So, what we have is a situation where people, who may or may have not certain expertise, have reached out to an agency that is still in the creation situation, to ask their advice and coordination.

And when they did that, though CFPB has no authority, no right, nor have they ever said that they can force anyone to agree to anything, nor do they have a vote at the table, so that the big crime here is that someone actually reached out and asked for advice.

Chairwoman CAPITO. That was your time, Mr. Capuano.

Mr. CAPUANO. I would suggest that is not only not only a crime, but it would be a crime to do otherwise.

Chairwoman CAPITO. I would like to recognize the chairman of the full committee, Mr. Bachus, for 5 minutes for questions.

Chairman BACHUS. Thank you. I would like to clarify something first.

When Ms. Warren testified in March before our committee, I specifically asked her if she had participated in negotiations. Her response was that she gave advice when asked. I then wrote her after the hearing and asked her if she would like to clarify.

And at that time, she did say that she had been an active participant with both Federal and State agencies. I consider that quite different from advice, because I had her asked her if she participated.

She was forthcoming in response to my letter, although most of the headlines at that time said that she gave the same response she gave at the hearing. You would have to be illiterate to think that. I don't think people read her response and compared it to her testimony.

In that letter in March, Mrs. Capito and I asked her for any documents pertaining to that participation. We didn't get those until last Tuesday night.

A lot of the documents were put out by Judicial Watch about a month ago. But it was Tuesday night of this week when we were given information which other independent sources had picked up.

I think the staff has handed you the "Perspective on Settlement Alternatives." This is a settlement proposal that the Consumer Financial Protection Bureau gave the attorney general back in February, is it not?

Mr. DATE. This is a document, Mr. Chairman, that describes—lending not comprehensively but in a way that is meant to propose ideas, put those ideas in—

Chairman BACHUS. No, it is more than an idea. You actually proposed a settlement of at least $25 billion. You actually say a $25 billion settlement would not be sufficient, do you not?

Mr. DATE. Mr. Chairman, I apologize. Would you mind?

Chairman BACHUS. Look at page two, where you say that servicers saved $20 billion, and $20 billion plus a $5 billion settlement seems too low.

Mr. DATE. No, Mr. Chairman. My reading—I am looking now at the top of the page.

Chairman BACHUS. Yes.

Mr. DATE. The second sentence says, "as a result, a notional penalty of roughly $5 billion would seem too low."

Chairman BACHUS. Yes, but you say that they saved more than $20 billion. Were you all proposing a $5 billion settlement or saying $25 billion wouldn't be enough?

Mr. DATE. Oh, I see. Here is what was done here. Obviously, there are a variety of ways to calibrate any kind of monetary penalty.

Chairman BACHUS. I am sure. But what I am asking is, you were suggesting that $25 billion would not be enough, correct?

Mr. DATE. No, I believe it says that $5 billion is not enough.

Chairman BACHUS. For a penalty.

Mr. DATE. If I am looking at—

Chairman BACHUS. For a penalty.

Mr. DATE. That is right, a notional penalty of roughly $5 billion is too low.

Chairman BACHUS. Okay. And you proposed that the settlement be used for principal reduction, correct?

Mr. DATE. Mr. Chairman, I would be happy to describe the analysis that underpins this document that, obviously, is in the public domain.

Chairman BACHUS. When you say, "A principal reduction mandate could be meaningfully additive to HAMP" on page six, and "PRM would mandate 3 million permanent modifications," you are advocating for a program to be an addition to HAMP or a HAMP-like program? Is that correct?

Mr. DATE. To be clear, this would be a component of a voluntary settlement.

Chairman BACHUS. I understand. Yes. You are right. You are proposing components of a settlement. Is that right?

Mr. DATE. That is right.

Chairman BACHUS. Okay.

Mr. DATE. Not by any means comprehensive. But the notion, just to ground what is here a bit, if it is helpful, is that because there are different means by which to think about the size of the penalty, what this principally does is it tries to say, well—and the analogy would be, "If I stole a car and it is your job to punish me for stealing that car, I don't know what the right way for you to punish me is, but you should probably take the car away."

That is, in general, the—

Chairman BACHUS. Sure. So you propose taking the $20 billion that they saved plus a penalty?

Mr. DATE. That would be a way in which—

Chairman BACHUS. Right. I am not arguing with you about the merits. I am just saying that you suggested that they saved $20 billion. So in addition to that, you believe they ought to pay a penalty, which—

Mr. DATE. Mr. Chairman, I don't think that is what is actually in this document. I am not contesting that reasonable people might think that. But I am just not sure I have seen that.

Chairman BACHUS. Yes. All right, let me close by saying this. You proposed that the money from this settlement be used for mortgage principal reductions, correct?

Mr. DATE. That is a facet of what is presented here.

Chairman BACHUS. Right. Okay.

Are you aware that we have a law, the Miscellaneous Receipt Settlement, that says that a settlement needs to go into the Treasury to pay down on the debt, as opposed to being used to create a new program?

Mr. DATE. I would not be able to tell you the specifics with respect to that. But I—

Chairman BACHUS. So you wouldn't be opposed to that, would you, that we just pay down the debt with this settlement?

Mr. DATE. Mr. Chairman, again, I should not—

Chairman BACHUS. Instead of—

Chairwoman CAPITO. The gentleman's time has expired.

Chairman BACHUS. I will close. But instead of a principal reduction, that would be an alternative, would it not?

Chairwoman CAPITO. The gentleman's time has expired.

Chairman BACHUS. Thank you.

Chairwoman CAPITO. The ranking member of the full committee is recognized for 5 minutes.

Mr. FRANK. I guess, I am here thinking of Claude Rains and his great role in "Casablanca" as the police chief. Apparently, my colleagues are shocked—shocked—that a leading consumer adviser to the President made suggestions about how we should deal with a major consumer problem.

I am absolutely baffled by what this is all about. Yes, Elizabeth Warren, who is a very able, very thoughtful expert in the field, apparently made some suggestions.

They weren't binding. They weren't coercive. She made some suggestions.

And instead of talking about the merits of the issues, we are in this panic or outrage that she dared do that. This is the silliest thing I ever heard of. I am very pleased that Ms. Warren made these suggestions.

Let me ask you, Attorney General Strange, were you attorney general in February of this year?

Mr. STRANGE. Yes, sir.

Mr. FRANK. Did you feel coerced by Elizabeth Warren? Did she threaten you in any way? Did you need to get protection against her?

Mr. STRANGE. I think I may have met her once in passing, but she didn't seem threatening.

[laughter]

Mr. FRANK. Thank you. I appreciate the—

Mr. STRANGE. Personally, anyway.

Mr. FRANK. Maybe some of my Republican colleagues will take heart from your courage in being willing to stand up against this incredible force, this Elizabeth Warren.

I guess, maybe it is a play that we should be writing: "Who is afraid of Elizabeth Warren?" She made suggestions. She actually made them in the form of coherent proposals.

Maybe if she was incoherent or internally inconsistent, my colleagues would have been less threatened.

And then, she had the temerity to suggest that those financial institutions, many of which made loans they shouldn't have made and packaged them into securities that shouldn't have been sold, and then incompetently serviced them, that they should pay some penalty.

That is consistent, because my colleagues on the other side have, throughout this, been very protective of the financial assets of the large institutions. Indeed, there have been complaints about the money that has been spent in part of this.

Under the bill that originally passed the conference committee last year, in the financial reform bill, there was a section that said $20 billion would come to administer this financial reform bill, including some of the mortgage relief for the unemployed and others, from an assessment on financial institutions that had $50 billion or more in assets.

And to get the Republican votes we needed in the Senate to pass it, that was transferred from the large financial institutions to the taxpayer. So there has been a consistency here, in terms of worrying that the financial institutions would be somehow unfairly put upon.

And the suggestion, apparently, the CFPB—actually, Ms. Warren suggested that the estimate be what they saved and a penalty. That might be wrong. That might be right. Maybe you want to do principal reduction. Maybe you don't.

I have been a little skeptical of too broad a scale principal reduction. Although where we are talking about the unemployed, I think there is a very clear case for that.

But the notion that it is improper for Elizabeth Warren to suggest that in a wholly non-coercive way—there is an obsession with Elizabeth Warren.

And let's be clear where it comes from. It comes from people who never wanted an independent consumer bureau, who wanted consumer protection to continue to be with the regulators whose job, as the chairman said, was to serve the banks.

They did not want independent consumer protection taken away from those regulators. We found in the Majority that the regulators had not done a good job, and we wanted to put consumer protection in an independent agency.

Part of what they want to do is to take away that independence, and give the bank regulators the right to overrule the consumer agency. But they don't like the consumer agency.

They haven't been able to make a head-on assault because it is kind of popular. Someone said what we have is, let us demonize Elizabeth Warren. Let us discredit the consumer agency by attacking the person who I think ought to be the head of it, and who had certainly played a major in coming up with the idea and worrying about it.

And what did they convict her of? In fact, I guess Ms. Warren should take comfort in the fact that the worst thing they can say about her, people who are really determined to kind of diminish her reputation—as the chairman said once, this isn't about Elizabeth Warren. But I wouldn't take a lie detector test on that.

The worst thing they can come up with to discredit Elizabeth Warren is that a woman charged with protecting consumers and looking out for consumer interests proposed a scheme, a plan for dealing with the mortgage situation.

How terrible of her. Shame on her that she would actually sit down and try and figure out what she thought was good, and then submitted in a wholly non-coercive, suggestive way to others.

I have to tell you that the attorney general wasn't intimated. I know Ms. Williams. Sometimes I wish I could intimidate her a little more than I have been able to.

I don't think she was in any way frightened by this. They would have different rules on preemption if she were more easily influenceable. I don't think anybody has ever said, oh, that Elizabeth Warren, she threatened to beat me up. She did all this to me—

Chairwoman CAPITO. Your time has expired.

Mr. FRANK. Come save me and protect me from Elizabeth Warren. And I hope—a little more time. To the chairman, another 10 seconds. I would just say this, I would like to—

Chairman BACHUS. Madam Chairwoman, I would like at least 30 seconds to respond to the—

Mr. FRANK. I don't see why—

Chairwoman CAPITO. Oh, hold it. Hold it. Hold it.

Mr. FRANK. Pardon me, but the gentleman—

Chairwoman CAPITO. In respect to this, you can finish in 10 seconds.

Mr. FRANK. The gentleman had 6 minutes. And I don't understand that we go back and forth and respond. That is not the 5-minute rule.

But the point is this. I will now offer to anyone who feels threatened by Elizabeth Warren, let us know, and I will do everything I can to protect them from this menace of a consumer protection advisor making suggestions.

Chairwoman CAPITO. Mr. Fitzpatrick for 5 minutes.

Mr. FITZPATRICK. Thank you, Madam Chairwoman.

Mr. Date, what is about the deficiencies of the mortgage servicers that justifies a principal reduction?

Mr. DATE. Thank you, Congressman, for the question.

As you point out, the deficiencies of the mortgage servicers, which principally have been documented by the examination of our sister agencies, are troubling in that they are pervasive and, within the scope of the examinations, quite profound.

And it is certainly a fair question to ask in those cases where violations, for example, of a law have taken place. So it would be a reasonable question, I suppose, to ask in a case of an active duty soldier who has been foreclosed upon in violation of the Service Members Civil Relief Act. What is the appropriate penalty for that kind of activity? And what is the appropriate remedy and how should it be structured?

Of course, there are a range of alternatives with respect to these questions. And that is precisely why I have been glad that the Secretary of the Treasury has asked us to try to inform those deliberations amongst the agencies that have authority here.

Mr. FITZPATRICK. For instance, do you see a causal link between robo-signing, on the one hand, and a particular mortgager or borrower being underwater? Is there a causal link, one to the other?

Mr. DATE. It is a good question, because the robo-signing, in the way that it is most customarily thought about, entails the systematically false provision of the affidavits with respect to various judicial mechanisms around mortgage servicing in particular.

And because, after all this is not the furniture business—it is not as if the paperwork is somehow ancillary to the main business. This is financial services. The paperwork is kind of the point, in that the documentation with respect to these transactions is meant to provide investors with the comfort that they have and that they need in order to put money into the system.

And it is meant to provide borrowers with the confidence protection that they have with respect to the credit transaction that they have entered.

Mr. FITZPATRICK. Attorney General Strange, you testified that you are concerned that the proposed settlement terms would force a State like Alabama, which is a non-judicial foreclosure State, to become a judicial foreclosure State. Can you expand on that?

Mr. STRANGE. Yes, Congressman.

My basic concern is that our State has chosen a method for handling home foreclosure. Our State legislature considered the alternatives and voted on it.

My concern is that a settlement of some kind that imposes on not just my State, but the 26 or 27 other States, the majority of States that have chosen this path, is somehow altered or converted without the approval of the legislature that put in place the original plan.

That is really my overarching concern. That kind of policy issue really to me seems to be a decision for the Members of the Congress here or for the members of the State legislature, not a group of attorneys general.

Attorneys general are very good at enforcing the law and preventing future illegal activities. They are not very good, in my experience, economic policy experts.

Mr. FITZPATRICK. Where you aware of the proposed settlement terms before they were sent to the mortgage servicers?

Mr. STRANGE. I have not been in the loop in terms of the details of the settlement, no.

Mr. FITZPATRICK. Do you believe it is the role of attorneys general to be involved in setting national servicing policies?

Mr. STRANGE. I do not. I believe it is our job to enforce the law, to protect consumers. As I mentioned in my testimony, that is a top priority of ours.

I believe the policy matters ought to be left to the policymakers, who are here in this room in the Congress and in the State legislatures.

Mr. FITZPATRICK. Okay. I yield back. Thank you.

Chairwoman CAPITO. The gentleman yields back.

The gentlelady from California is recognized for 5 minutes.

Ms. WATERS. Thank you very much, Madam Chairwoman.

I don't know if I have questions as much as I am perplexed about how this subprime meltdown, which has caused all of these foreclosures, and the so-called efforts to help homeowners has could fail so miserably.

This review, I guess that was led by OCC—was it—that supposedly found about 14 loan modifications that have been turned down and haven't been done correctly. Where is that? Are you familiar with that, Ms. Williams?

Ms. WILLIAMS. Congresswoman, are you referring to the—

Ms. WATERS. The interagency foreclosure review.

Ms. WILLIAMS. The interagency foreclosure review.

Ms. WATERS. Are you familiar with that?

Ms. WILLIAMS. I am familiar with that report, yes.

Ms. WATERS. Are you familiar with the fact that out of 2,800 files, they found a small number of foreclosures that should not have proceeded because the borrower was a member of the military, covered by the Service Members Civil Relief Act?

Is that what you understand they found?

Ms. WILLIAMS. That is correct. But as I said in my testimony, the horizontal examinations—

Ms. WATERS. I can't hear you.

Ms. WILLIAMS. The horizontal examinations that were done relied on a sample of loan files of each of the servicers. So there was a limited sample that was covered in those exams.

Ms. WATERS. We have basically projected out, with the number of foreclosures that have taken place, that exactly 10,000 homeowners probably had been wrongfully foreclosed upon. Did you do those kind of projections?

Ms. WILLIAMS. Congresswoman, the purpose of the look-back process that is part of the enforcement orders issued by the OCC and the other banking agencies is to specifically identify homeowners who were financially harmed as a result of the deficient practices.

So we have not done a look back of the envelope extrapolation. What the enforcement orders require is a very robust process using independent consultants to identify homeowners who did suffer financial harm as a result of the petition.

Ms. WATERS. I am not so sure what that means, but let me tell you what I experienced in working with servicers. I did get some waivers from homeowners. We were bombarded with calls and we started calling trying to find out what was going on. And over a period of time, it was just unbelievable.

First of all, they lost records. Was that identified, how many records get lost all the time? Is anybody aware of that?

Ms. WILLIAMS. Yes.

Ms. WATERS. Also, are you aware of the problem of fees? Homeowners sometimes, even if they get to modification, by the time they pay the late fees, the attorney's fees, the brokerage price opinion fees, the process fees that the mortgages back up, the payments back up where they were before they got the loan modification. Are you familiar with that?

Ms. WILLIAMS. The area of fees, whether fees were excessive, whether they were reasonable and customary, whether they were specifically authorized by the loan document that the borrower had with that particular lender, is an area that will be specifically looked at in this look-back process, pursuant to our enforcement order.

Ms. WATERS. Don't you think that consumers should have more protection than anyone should be able to say that you signed this document and you agreed to all of these fees. I am sure you are aware that most people don't know in that fine print that they have all of these brokerage price opinion fees and process fees.

Most consumers don't know that. Wouldn't you agree?

Ms. WILLIAMS. I think that consumer disclosures is an area where there is a lot of room for improvement in the financial services arena. And we strongly support that.

Ms. WATERS. Since we have three of the too-big-to-fail banks—Bank of America, Wells, and Chase—who have 60 percent of all servicing, don't you think we ought to be able to get our arms around that? They are the ones who are doing all of this servicing.

In addition to all of the lost papers and the fees, etc., I discovered that many of these servicers were not very well trained. Has that been looked at? And has something been done about that?

Ms. WILLIAMS. That has also been looked at. And there are provisions in our enforcement orders that specifically addressed staffing, both in terms of numbers and training of staff involved in the servicing loss mitigation, loan modification, and foreclosure process.

Ms. WATERS. Are you aware that at Bank of America, when one first calls to try and get some help, they go to a loss mitigation that is offshore, oftentimes?

Ms. WILLIAMS. I am personally not aware of that.

Ms. WATERS. Would you check it out?

Ms. WILLIAMS. I certainly can.

Chairwoman CAPITO. The gentlewoman—

Ms. WATERS. Thank you. I yield back.

Chairwoman CAPITO. Mr. Hensarling for 5 minutes for questions.

Mr. HENSARLING. Thank you, Madam Chairwoman.

Ms. Williams, in your testimony, you talked about the examinations that were produced by your agency and several others, the prudential regulators. I believe there was a sample size of 2,800 borrower foreclosure cases, correct?

Ms. WILLIAMS. Yes. That is correct.

Mr. HENSARLING. How was that sample chosen?

Ms. WILLIAMS. First of all, the sample was 200 per servicer. It was a judgmental sample, determined by the examiners responsible for the particular institution. There was a mix of judicial and non-judicial States that were—

Mr. HENSARLING. Did the agencies consider it to be representational of the larger universe? As I understand it, there are 1 million, 2 million, maybe 3 million under the consent decree, foreclosure cases that the mortgage servicers are going to be required to reach out to. Is that correct?

Ms. WILLIAMS. The samples were intended to be representative of the types of standards and of the processing centers and—

Mr. HENSARLING. Okay. On page four of your testimony, you say, "In general, the examinations found that the loans in the sample were seriously delinquent."

So I think you are telling me that at least you consider the sample to be representational. The loans in the sample were seriously delinquent.

I know that mortgage servicers have gone out and done a lot of bad and sloppy work. And now I am trying to figure out the extent of it.

So, to some extent, what we are trying to figure out here is just how widespread this damage is. So it sounds like the vast majority of these loans, there are going to be foreclosure proceedings against these people anyway.

I will ask anybody else on this panel, is there another sample size between the 2,800 borrower foreclosure cases that your agencies have examined? And what is the number of those who have been foreclosed upon who were not "seriously delinquent."

Do you have a number, anybody else on the panel?

So what we know is limited to this 2,800 sample size. And the conclusion is that these folks were seriously delinquent.

Mr. Date, in your testimony, you say that the Bureau is not yet open for business. It sounds like you have been pretty busy for an agency that is not yet in business.

In your term sheet, you clearly suggest a $20 billion settlement. I am looking at your term sheet dated February 14th, although I don't see a page number. I am sorry, on page two, you suggest a $20 billion settlement.

I guess my question is this, you have been charged with protecting consumers and you are also suggesting $20 billion in principal write downs, is that correct? And I believe you testified earlier that was "an aspect to it."

Did I hear you correctly, Mr. Date?

Mr. DATE. Yes. But just to clarify, you are referring, I am assuming, to the presentation called, "Perspective On Settlement"—

Mr. HENSARLING. Correct.

Mr. DATE. And not, by contrast, the 27-page State attorney general term sheet that I believe was—

Mr. HENSARLING. Wasn't this your perspective of what a term sheet should be?

Mr. DATE. The term sheet is rather more comprehensive than the—

Mr. HENSARLING. Okay.

Mr. DATE. That is the distinction I am trying to draw.

Mr. HENSARLING. Here is my question. If you are suggesting a $20 billion in principal write down, we know right now that already the taxpayers are out $150 billion so far in the GSEs. The Fed, I believe, has invested over a trillion or about a trillion dollars in mortgage-backed securities already.

That deals with taxpayers not consumers. But every single investor group I know of in America is fearful of a government-forced principal reduction.

And so I guess my question is this. If you are there to protect consumers, does a robust private capital mortgage market—does the CFPB consider that to be part of consumer protection, yes or no?

Mr. DATE. Access to financial markets is a part of our mandate, Congressman. I am happy that it is.

Mr. HENSARLING. So would you be concerned if there was less private capital coming into the market because of this global settlement that you suggest?

Mr. DATE. Congressman, I am concerned that the pervasive and profound deficiencies in mortgage servicing have made it difficult for mortgage private label investors to have confidence in how it is that their assets are going to be serviced. I think we should all share that concern.

Chairwoman CAPITO. The gentlemen's time has expired.

The gentleman from Texas, Mr. Hinojosa

Mr. HINOJOSA. Thank you, Madam Chairwoman.

I ask unanimous consent to insert into today's joint hearing record Supplemental Directive 11–06, entitled, "Making Home Affordable Program—Updates to Servicer Incentives," dated July 6, 2011.

Chairwoman CAPITO. Without objection, it is so ordered.

Mr. HINOJOSA. Thank you.

Last month, the Treasury Department rated the performance of the 14 largest servicers participating in the Making Home Affordable Program, ranking them on three criteria: number one, identifying and contacting homeowners; number two, homeowner evaluation and assistance; and number three, program management reporting and governance.

Treasury determined that six of the servicers needed moderate improvement and four needed substantial improvement in the first quarter of 2011. None of the servicers needed only minor improvement.

The interagency review of foreclosure policies and practices found that, "individuals who signed foreclosure affidavits often did not personally check the documents for accuracy or possess a level of knowledge of the information that they attested to in those affidavits.

"In addition, some foreclosure documents indicated they were executed under oath when no oath was administered. Examiners also found that the majority of the servicers had improper notary practices, which failed to conform to State legal requirements. These determinations were based primarily on servicers' self assessment of their foreclosure processes and examiners' interviews of servicer staff involved in the preparation of foreclosure documents."

It seems to me that there is room here for investigation claims that borrowers are often charged exorbitant and unjustified forced place insurance. Can one of you tell me how this is being handled so as to help these individuals we are trying to help out?

Ms. WILLIAMS. Congressman, I can start.

Mr. HINOJOSA. Yes.

Ms. WILLIAMS. The issue of fees and whether borrowers were charged unreasonable fees, fees that were not reasonable and customary, or fees that were not authorized under the terms of the agreements that they entered into, is an element that is part of the look-back process pursuant to our enforcement orders.

So that is one of the things that will be part of the review of the borrowers who are in the scope of that look-back.

Mr. HINOJOSA. Anyone else?

Mr. DATE. Congressman, I know that Title XIV of Dodd-Frank appropriately, to my mind, includes the request for the Bureau to undertake an evaluation of this forced-place insurance issue and includes rulemaking authority. Obviously, anything that the Bureau would do in this respect would be grounded in real analysis on what the impact would be and whether it would, in fact, help the market and help consumers.

Mr. HINOJOSA. We have seen an impact that the actions of the top 14 servicers had on our military servicemen, servicewomen, who put their lives at stake each and every day to protect us here in America. What actions can be taken to ensure that those troops are protected from unscrupulous lenders and mortgage servicers?

Mr. STRANGE. Congressman, from the law enforcement perspective, we are seeking and extremely interested in any instance like that. And I am sure I can speak for all the attorneys general that if that type of activity comes to our attention, we will pursue it to the fullest extent of the law.

Ms. WILLIAMS. Congressman, actions have already been taken by the Department of Justice in some respects. But I think the short answer to your question is 100 percent compliance with the Servicemembers Civil Relief Act.

Mr. HINOJOSA. That is good to know.

With that, Madam Chairwoman, I yield back.

Chairwoman CAPITO. The gentleman yields back.

Mr. Royce, for 5 minutes.

Mr. ROYCE. Thank you, Madam Chairwoman.

I am going to ask Ms. Williams some questions.

And Ms. Williams, I am not a fan of bifurcated regulation. I think it has had some very adverse consequences. But as I mentioned in my opening statement, the number of existing or proposed servicing standards is pretty daunting.

You have HAMP, FHFA for Fannie and Freddie, individual State laws, bank regulator consent orders, the bank regulator joint interagency initiative, the legal settlement reported in the press. You have risk retention for qualified residential mortgages. You have congressional proposals.

You have the potential activity by the CFPB. And I quoted from the New York Times, in terms of the overhang or the inability here. I think you have 60-some years worth in New York State in order to work through the backlog.

So you mentioned in your prepared testimony that the OCC supports the development of a uniform servicing standard. And you are all working with the various regulatory agencies to come up with such a standard.

I wanted to ask you about that. And I was going to say, looking at the backlog of foreclosures throughout the country, what impact does the lack of a clearly defined set of rules have on the confusion throughout the market?

Is that adding to the delays? And does that add perhaps to recovery when you have that amount of confusion out there?

Ms. WILLIAMS. To the extent that lenders and servicers are uncertain about what the rules of the road are in proceeding with their mortgage servicing and with the foreclosure process, that does slow down the process.

As I said in my testimony, there are under way right now a number of different initiatives that deal with mortgage servicing, in the larger sense, mortgage servicing with respect to current and performing loans, loss mitigation, including loan modification efforts, and also the foreclosure process, and of mortgage servicing.

And we do think that it is very important for the different players to try to bring those together to be as consistent as possible, so that there is a single set of standards, to the extent possible, so that the servicers clearly know what is expected of them, and so that customers know what to expect from their servicer.

Mr. ROYCE. The committee has heard a lot about coordinated rulemaking efforts. I can just give you my take on this sitting through the hearings and then talking to people in the regulatory community about their feelings.

And the truth seems to be that there is little communication and coordination occurring in many, many ways, partly due to regulatory turf battles, partly the fact that we just don't have this one clear set of rules.

And I think it is in everybody's interest to see that this is done right. But let us say for a minute the New York Times is right in this story of a week-and-a-half ago. Let us say that New York State, that it will really take lenders 62 years at the current pace.

What might that portend going forward? How are we going to see a return to the private market when we are building so many inconsistencies into the system?

Ms. WILLIAMS. Congressman, I don't recall all of the details of the article that you are referring to. But it is premised on the current pace. One would hope that that current pace isn't going to be the pace going forward once we got some clarity in the standards that are expected going forward.

Mr. ROYCE. As the story goes through also other States, New Jersey 49 years, Florida, Massachusetts, Illinois—it would take about a decade in those States. So, again, we are dealing here with bifurcated regulation, with 50 different States, with 50 different sets of rules.

And even at the Federal level, bifurcated regulations without the common standard yet. Until we get it, it is hard to figure out how we move out of this morass and sort things through in the marketplace with respect to the overhang.

I yield back, Madam Chairwoman.

Chairwoman CAPITO. The gentleman yields back.

Mr. Miller, from North Carolina, for 5 minutes for questions.

Mr. MILLER OF NORTH CAROLINA. Thank you, Madam Chairwoman.

The American people are justifiably skeptical and I am skeptical that anybody who has been involved in all this, who is supposed to be independent, has actually been independent. That certainly was true at the rating agencies. Everybody involved seems to have deep business ties with each other.

And even when they are supposed to be looking after somebody else, they seem to be just looking after each other. It is all the same folks, whether they are called servicers or trustees or securitizers or whatever else.

Ms. Williams, the consent order a couple of months ago with the 14 servicers required an independent review, a consultant's independent lay review of some of the files.

Mr. Pearce, in his testimony, said that review should include all foreclosures where the homeowner had applied for modification or had filed a complaint against a servicer or was a member of the military, and that because of the importance of the review and the skepticism about whether they are really independent or not, that there will be an interagency group that would sample the reviews and look hard at them to see how they had been done.

Do you agree with that?

Ms. WILLIAMS. I think the approach that we are taking at this point is to share information. We have been sharing information among the agencies that have been participating in the reviews in other respects. But we have not gotten to the point of having sort of an interagency second review as part of that process.

Mr. MILLER OF NORTH CAROLINA. Are you telling me, then, you are taking a—whether or not you are doing it in consultation with others or with an interagency group, I took that to be that the FDIC was volunteering to be part of an interagency—just as in Mr. Pearce's testimony, they volunteered to work with you in that and be part of an interagency operation.

But you say that you are taking a hard look at a reasonable sample of those files?

Ms. WILLIAMS. Oh, absolutely.

Mr. MILLER OF NORTH CAROLINA. And does it include all of those, whether it is in the foreclosure, where the homeowner applied for modification or filed a complaint or is in the military?

Ms. WILLIAMS. What we are in the process of doing is identifying the level of review for different segments, different high-risk segments, and what the factors are that will trigger a 100 percent review versus the sampling approach.

Mr. MILLER OF NORTH CAROLINA. Okay. There is a further concern that contributes to the skepticism of the American people and me. Brandeis said that the best disinfectant was sunlight, and the street lamp the most efficient policeman. There has been no light on most of this. All of this has been in the dark.

Will the result of those reviews be public? To what extent will it be public, so the public can look over your shoulder and decide whether you are really being an independent watchdog, as you were supposed to be?

Ms. WILLIAMS. Congressman, what we anticipate is probably two public-type reports as we go through this process. One, an interim report to describe the structure of the look-back process, sort of the details of how the whole process is going to be conducted. And this will get to some of the questions that you just asked.

And then a report at the end of the process that will be similar to the interagency horizontal report—

Mr. MILLER OF NORTH CAROLINA. Reports from the consultants, the independent—

Ms. WILLIAMS. No, the reports that the agency would put out describing the—

Mr. MILLER OF NORTH CAROLINA. Their review?

Ms. WILLIAMS. —the look-back process, describing the findings, describing the financial remediation that would be provided.

What we would not anticipate doing is having bank-specific information because that is confidential bank supervisory information, but providing information about the scope and the details across-the-board.

Mr. MILLER OF NORTH CAROLINA. Mr. Pearce, do you have a response to the question about the necessary views that address your testimony?

Mr. PEARCE. I guess I would say that people have been skeptical about what has gone on in the mortgage servicing, and whether the servicers that have made errors in following State laws and other laws that have been on the books for a long time, whether they are going to be held accountable for that.

And so I think the FDIC's view, in consultation with our fellow regulators, is that that this look-back process really does need to be robust. And it needs to look at the areas where we think there is likely to be harm.

As Ms. Williams stated, the sampling approach can really identify where there might be errors and then how many errors you might find there. But it won't go all the way for these high risk segments, like borrowers who applied for a loan modification and then ended up through foreclosure that—excuse me.

Just to finish up, having a full review of those files seems to be pretty fundamental, in our view.

Mr. GRIMM [presiding]. Thank you.

Representative Hayworth, you are recognized for 5 minutes for questioning.

Dr. HAYWORTH. Thank you, Mr. Chairman.

Mr. Date, in particular, there have been questions about whether or not the CFPB should be viewed primarily as a banking—or substantively as a banking regulator or more as a consumer protection agency to the extent that it has considered itself, if you will, or if it is considered to be a banking regulator, then the Federal Financial Institution Examination Council's policy presumably would be applicable to the CFPB's actions, vis-a-vis some type of financial institutions obviously.

And in the assessment of penalties and in this prospective document that we have all been talking about, there was reference to penalties in particular regarding deficits in mortgage servicing.

There are mitigating factors that have to be considered in terms of FFIEC policy. There is the whole list of mitigating factors, including the size of the institution, evidence of past violations, evidence of concealment, etc., that themselves flow from certain statutory requirements regarding banking regulations.

So how is the CFPB considering its activities in terms of those FFIEC guidelines?

Mr. DATE. Thank you, Congressman.

With respect to specifically the FFIEC guidelines, broadly speaking, the Bureau will, as my understanding, participate in the FFIEC. The Bureau's Director will be a member of the Financial Stability Oversight Council.

I spent most of my career as a banker. I can assure you that in that capacity, someone with supervisory authority over, for example, the Truth in Lending Act and RESPA, etc., I would view it as a bank regulator. And that is certainly how it is that we are thinking about what we are setting up.

With respect to the mitigating circumstances associated with any putative settlement, I am confident that the people at the table, in terms of the Department of Justice and the State attorneys general, as well as presumably the legal representatives of whatever servicers might be involved, are considering and making arguments about mitigants in the industry.

Dr. HAYWORTH. So, in other words, you are not necessarily subscribing specifically to FFIEC policy. That hasn't been internally determined, yet it is still all under consideration?

Mr. DATE. For context, I will explain my role at the Bureau, but then also point towards what might be a productive answer to your question. I think examination practices in the main.

My role at the Bureau is really running the division called Research, Markets and Regulations. There is an Assistant Director for Depository Supervision who, among other things, has been recruiting a team that is ready to take over supervisory authority with respect to the specifically enumerated Federal consumer financial protection laws, as of July 21st.

And they have been hard at work to make sure we are ready to use guidelines, policies, and procedures to that end. Again, my understanding is that would be in light of existing protocols, and to the extent possible coordinated.

Dr. HAYWORTH. The importance being obviously that since we are talking about penalties being assessed against banks in regard to their relationship to the mortgage servicers—obviously, you are getting in that issue through the banks here. And we are talking about the broader issue of bringing private capital into the mortgage marketplace, encouraging that.

If penalties are assessed without due consideration for what banks, as you know very well, consider to be a policy that they understand and are familiar with, then it increases the uncertainty. It might deter further or enlarge participation by private capital in the marketplace.

Any comments by any of our other panelist would be welcome in that regard.

Mr. PEARCE. I guess that from the FDIC's point of view, I think we are concerned that the servicing errors have really created an environment where there may be lots of different litigation and claims at either the State level or Federal level, not only bank regulators or the Department of Justice, but there may be other Federal agencies or other State regulatory authorities that have issues.

So the range of government parties out there that may have some claim related to servicer errors. There is private litigation going on relating to loan modification programs, enhanced and non-enhanced, whether a chain of title is secure in that.

And so I think the point there is that resolving these issues is really important to get private capital back in the marketplace, and so a comprehensive resolution, we would like to see that if we can.

Mr. GRIMM. The gentlelady's time has expired.

The gentleman from Georgia is recognized for 5 minutes.

Mr. SCOTT. Thank you very much, Mr. Chairman. I appreciate that.

As I mentioned in my opening remarks, we had extraordinary success in Atlanta, Georgia, with our home foreclosure event. And Mr. Raj Date—I hope I didn't do too much injustice to your name there. But you are with Treasury, although you are with the CFPB—is that correct?

Mr. DATE. During the stand-up period for the CFPB, the Bureau of which I am an employee is under the governance of the Secretary of the Treasury, during that—

Mr. SCOTT. Excellent. The only reason is I want you to get a message to the Treasury for me, especially Ms. Alvina McHale, Assistant Secretary Kim Wallace, and the acting Secretary for the U.S. Treasury Office of Financial Stability, Tim Massad. They really worked tremendously in making such a success that we got over 2,000 homes prevented from foreclosure in this event.

It opened my eyes to a world of which I was only dimly aware. And I feel so much stronger now about how we can attack and solve this problem.

This is a war that we have going out here. And so many of our American people and the struggling homeowners are just victims because of a lack of information, or a lack of access for that information. For it is there. We have a plethora of programs.

And the reason we were able to solve this—and people came out. As I have said before, thousands and thousands. I walked the lines. I talked with thousands of people, so I learned exactly what was on their minds. The complaints about the loan servicers not returning calls, multiple people, people foreclosing without the proper knowledge of the loan, etc.

People were very, very frustrated. But when we were able to get in there, we were able to solve those problems.

But there are two points I want to address here. One is the HAMP program, which has come under a lot of criticism—but let me tell you that we were able to effectively use HAMP in over 200 of those cases right there on the spot.

And the reason for that was because there are some banks, like Bank of America was there, who made the decision to bring their—what do you call—loan underwriters. Excuse me. When they brought their underwriters there, they could do the deal right there.

This was a major move. And it should be encouraged.

So, I really believe that if your Department continues that kind of work and outreach—if it worked in Atlanta, Georgia, that way, just imagine what that would be if it was done over and over. Like I said, it is a war. We have to get this information out to the people and make sure that happens.

I do want to get your comments, especially the Office of the Comptroller of the Currency and the FDIC, on the move that you are making to deal with the loan servicers' issues and deficiencies which is this consent agreement.

Could you tell me exactly, and the American people, what that is and why we are having the consent agreement? And then explain which types of servicers are not subject to the consent agreement? This I understand is a major tool that we are using now to address some of these deficiencies of the loan servicers.

Ms. Williams, could you start?

Ms. WILLIAMS. The reason why we have these consent agreements is because there were serious deficiencies in the foreclosure processes of the large mortgage servicers.

And the consent agreements are extensive. They require major changes in significant areas of the servicers' compliance, governance, mortgage servicing oversight, loss mitigation, including loan modifications, foreclosure processes, MIS.

They are very comprehensive.

Mr. SCOTT. Why are certain loan servicers not subject to the consent agreement and others are? Why is that? And who are they?

Ms. WILLIAMS. When we embarked on the interagency horizontal exam, the 14 largest federally-supervised mortgage servicers were identified, just in looking at the volume of mortgages that they handle. And so those were the entities that were subject to the interagency exam process.

None of those entities came out of it with a good grade. And so, therefore, all of them are subject to the orders.

Mr. SCOTT. Okay.

Chairwoman CAPITO. The gentleman's time has expired.

Mr. SCOTT. Thank you, Madam Chairwoman.

Chairwoman CAPITO. Mr. Canseco, for 5 minutes.

Mr. CANSECO. Thank you, Madam Chairwoman.

Ms. Williams, I am curious about the overall goal of the consent orders that the OCC and other agencies have provided the banks. And as a follow up to my colleague, Mr. Scott here, let me ask you this, please expand on what exactly the OCC is trying to do with the guidelines they are requiring banks to follow?

Ms. WILLIAMS. What we are trying to do with the guidelines with respect to servicing practices or all of the guidelines—

Mr. CANSECO. Servicers' practices.

Ms. WILLIAMS. —in the consent?

What we are trying to accomplish with the—I will call them the action plans is what they are referred to in the consent for mortgage servicing procedures, loss mitigation activities, foreclosure processing, is to make sure that there is a rigorous process with integrity in handling the way that those operations are conducted by the servicers, that customers are dealt with properly, that the servicers are making decisions based on accurate and complete information, and that they are conducting themselves in accordance with all of the applicable State and Federal laws in how they operate.

Mr. CANSECO. These consent orders or consent decrees, will they do anything to reduce foreclosures?

Ms. WILLIAMS. They could to the extent that there are foreclosures that have been based on incorrect information, that have been based on, for example, incorrect information about amounts owed or fees that have been charged.

Mr. CANSECO. But not to the extent that it is going to prevent somebody who has not been paying his mortgage, prevent them from being foreclosed on.

Ms. WILLIAMS. No, sir.

Mr. CANSECO. Okay. There has allegedly been some discussion among the regulators about changing the way in which mortgage servicers are compensated. And one idea apparently being floated would pay servicers less for performing loans and more for non-performing loans.

And my concern is that this conversation among regulators is focusing only on the larger servicers, and little attention is being paid to community-based servicers that have close relationships with borrowers.

So since the loans at these banks tend to perform much better, simply because of the personal relationship that they have with their community, any cut in service compensation for performing loans would cause smaller servicers to get out of business.

And these servicers might not be the most efficient in the industry, but their business model is exactly what some customers are looking for. Has your agency, the OCC, considered the impact on community lenders of these proposed changes that would change the way servicers are compensated?

Ms. WILLIAMS. Congressman, the initiatives that you are describing are actually not initiatives that my agency or the other Federal bank regulatory agencies have commenced. The FHFA and I believe HUD, together with the GSEs have embarked on a significant initiative to revisit the compensation structure for the GSE-held mortgages and the servicing of those mortgages.

So, the driver of the standards or the potential changes that you are describing are the GSEs, the FHFA and, I believe, HUD. I completely agree with the point that you are making about the implications for community institutions.

Mr. CANSECO. Thank you.

Mr. Pearce, would your answer be the same?

Mr. PEARCE. Yes. I would agree that it is a process that HUD and FHFA have taken on to look at servicing initiatives. And I do think we want to be careful here that problems we have identified really are in the larger institutions that have sort of the economies of scale and different foreclosure and loss mitigation and collections departments.

And so the problems we have seen really been, the right hand doesn't know what the left hand is doing, and the borrower falls through the crack.

Mr. CANSECO. Right.

Mr. PEARCE. But that has not been the problem in community banks.

Mr. CANSECO. Okay. Great. I appreciate your answer. And I don't mean to be rude by cutting you off, but I am running out of time here.

I want to know from both of you, have you considered any measures that would help to keep high-quality community-based servicers in their business, especially those involving community banks and other smaller servicers?

Mr. PEARCE. I am sorry. I didn't hear that.

Mr. CANSECO. If you have considered any measures that would help to keep high-quality community-based servicers in business, in your rules and regulations and orders?

Mr. PEARCE. Certainly, as the primary Federal regulator for most of the community banks, we didn't find those problems in those institutions. And we are very concerned about new initiatives and are paying attention to that.

Mr. CANSECO. Thank you, sir.

And Ms. Williams?

Ms. WILLIAMS. I think that is something that we should certainly be sensitive to in doing interagency mortgage servicing standards.

Mr. CANSECO. Thank you both very much. And I yield back my time.

Chairwoman CAPITO. Mr. Perlmutter for 5 minutes.

Mr. PERLMUTTER. Thanks, Madam Chairwoman.

I want to follow up on Mr. Canseco's line of questioning and just come at it a little differently.

My law firm, for many years, had a general practice. We represented a lot of lenders, a lot of financial institutions. And so, from time to time, when the economy went south, we did a lot of foreclosure work.

Sometimes, we were swamped, and we couldn't process as fast as our client wanted us to. And, ultimately, I am going to get to you, Mr. Attorney General.

But, in this instance, we have a huge number of foreclosures into the system. So we got all sorts of competing pressures. But there is this need for speed, so to speak.

But where I have seen the excesses and where I am concerned about—before I get there, just a public comment. The new form that CFPB has done on disclosures when you take out a loan, good work. I just want to applaud you for that.

But getting back to the default side of all this—not the lending side, but the default side—we have the biggest banks, and we have Fannie Mae and Freddie Mac. And, generally, they pay a certain amount to process a foreclosure. Isn't that right? Like $650 for the foreclosure and "X" number of dollars for the bankruptcy. Correct? Mr. Attorney General, I don't mean to ask leading questions, but am I off base on that? There is a standard—

Mr. STRANGE. I am sure there is.

Mr. PERLMUTTER. There is a standard payment for the bulk of the foreclosures that are processed, unless they are a private kind of a loan that has been made?

So, within that amount that mostly Fannie Mae and Freddie Mac pay to have a foreclosure process, now we have this tremendous number of foreclosures coming through. And now we have, as opposed to what I used to deal with, there is sort of a middle man who is taking charge of the default process, the loan process servicer, LPS, or whatever they are called.

And from my review of the cases and the consent decrees, that seems to be where we have a lot of problems.

Mr. Attorney General, can you sort of expand on that? Am I off base or—

Mr. STRANGE. I think you are describing the situation and the problem. I think that is a new twist to the whole experience. It sounds like yor experience with this issue is similar to mine.

As the individual cases state law process—that is still really typically the situation in Alabama, in my State.

Mr. PERLMUTTER. So, we have this massive number of foreclosures that have to be processed. And the client who is up here could be a big bank one or could be a Fannie Mae number one.

You have a loan processing servicer company here, and then you have lawyers and title companies down here. How in regulating all of this—Ms. Williams you were talking about some standardized processing, because we have State-by-State laws.

But how would you approach this? Because I think in your testimony, you talked about trying to standardize this stuff.

Ms. WILLIAMS. What we found in our examinations—and it is part of the areas where additional corrective action is required in our orders—is that the oversight of these, I will call them third-party vendors, and they include law firms, but they also include the paper processor, packagers.

The large servicers relied significantly on third-party vendors of different types to do important components in the foreclosure process. And they did not oversee them properly.

We have guidance that we have issued, supervisor guidance that deals with oversight of third-party vendors that banks use, regardless of what particular service is being provided. That guidance was pretty well ignored in the oversight of the law firms and wasn't adequately applied elsewhere.

Mr. PERLMUTTER. And so that sort of reminds me of what used to be doctor-patient, then it became doctor-insurance company-patient. Here it is client-servicer-lawyer. And hearing from the lawyers, they were getting nicked like crazy by the servicer, almost a RESPA in reverse, that they would have to payback kickback, if you will, moneys to the servicing company.

Then, there was this piecemeal or piece process, where they just had to speed these things through. And you lost the lawyer-client relationship.

And I don't know if in Alabama, there are ethics issues that are going on. I want to be here on behalf of the lawyers to say, let them do their job.

Mr. STRANGE. I agree with your comment. And some of the things I pointed out in my testimony that I think are good, as far as this overall negotiation process, the single-point contact, the dual-track negotiations, eliminating this robo-signing problem, verifying accounting information, a lot of things that consumers deserve and should have in a simple forum are very good parts of this whole discussion.

Chairwoman CAPITO. The gentleman's time has expired. Thank you.

Mr. Luetkemeyer for 5 minutes for questions.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

Mr. Strange, just very quickly, I am curious, how many cases have you filed so far in your investigatory work against servicers?

Mr. STRANGE. In our State?

Mr. LUETKEMEYER. Yes.

Mr. STRANGE. I don't know of any at this point.

Mr. LUETKEMEYER. Okay. How long have you been investigating them?

Mr. STRANGE. I have been in office for 5 months.

Mr. LUETKEMEYER. Okay. You are following a predecessor. Are you initiating—

Mr. STRANGE. We have had a lot of organizing to do. But we have a very robust consumer protection division. We have received lots of information, complaints that we are pursuing.

But I couldn't comment on specific investigations right now.

Mr. LUETKEMEYER. Can you give me a number of complaints? I know you can't get specific.

Mr. STRANGE. In the hundreds.

Mr. LUETKEMEYER. In the hundreds. What would be the fine for someone who is deemed to have committed fraud here or committed an offense? What would be the fine?

Mr. STRANGE. I think it depends on what the offense is, obviously. And I would have to get back to you on that. I am not exactly sure. It depends on where they fall.

Mr. LUETKEMEYER. Okay.

Mr. STRANGE. I would be happy to get that information for you, though, for our State.

Mr. LUETKEMEYER. Thank you. What do you see, so far as—I think we have had a pretty good discussion this morning—afternoon now, I guess—with regards to the events that all transpired, and how it has all come about with regards to some of the servicing, obviously, has fallen short here.

And now in the default process, there is, obviously, some lack of communication, probably some other shortfalls. Is that what you see so far? Are there some other players along the line here that did some inappropriate things as well?

Mr. STRANGE. Most of the complaints that we receive are lack of communication or a lack of understanding of the process. And it can be from lots of different sources or reasons. We try and do everything we can to inform the consumer and then try and adopt the approach that I think Congressman Scott mentioned, get people together so that they can get the information. And oftentimes, that will solve the problem.

Mr. LUETKEMEYER. Okay.

Mr. Date, I am just kind of curious. A while ago, you were talking about, basically, the 14 mortgage servicers have 50 percent of the market, roughly. And then, you were talking about working with all the stakeholders. And you included academics in that.

Can you explain how the academics are part of the stakeholders in mortgage servicing?

Mr. DATE. What we have tried to do within the Bureau broadly, and certainly within our work in our research and markets team, is to make sure that we are plugged in to both the actual pragmatic market reality of how these financial markets work, operationally how do they work, how do the financial incentives work, what is the structure and concentration in the markets, and then, simultaneously, be aware of and be on top of advances in the conceptual understanding from a research point of view.

There are lots of great economists, for example, who are in the employ of the bank regulatory agencies. But we really know that we don't have the monopoly on good ideas or different perspectives. So we want to make sure that we are talking and getting the insights and the perspectives of a wide range of people.

Mr. LUETKEMEYER. Even those people who are not on the ground dealing with it everyday? That is just kind of curious. It is kind of interesting to me, how they can impact it, since they don't have a working knowledge of it, because they are not there everyday? They are just conceptualizing.

Mr. DATE. Congressman, I appreciate your point, certainly. But I will say that when I was in the business, I would occasionally talk to academic researchers. It is a different perspective and, therefore, valuable.

Mr. LUETKEMEYER. Okay. That is fine.

In April, a letter from the Center for Responsible Lending was sent to Federal bank regulators stating the preference for State solutions to addressing deficiencies in the mortgage servicing as opposed to solutions crafted by the Federal Government. Does the CFPB concur with this position?

Mr. DATE. I am sorry. Would you mind? I couldn't quite—

Mr. LUETKEMEYER. In April, there was a letter sent from the Center for Responsible Lending to the Federal bank regulators stating the preference for State solutions to address the deficiencies in the mortgage servicing, as opposed to solutions crafted by the Federal Government. I just asked if CFPB concurs in this position.

Mr. DATE. The CFPB has the advantage structurally of being able to have supervision authority with respect to Federal consumer protection laws, irrespective, when we have our full authority, of a particular charter or locale that the servicer is in.

So it does allow us, over time, to be able to be a meaningfully additive voice to creating a baseline that is consistent across-the-board.

That said, much of the constraints on the mortgage market, because of the size of the real estate market, are matters of State law, which is why I assumed that the State attorneys general figure so prominently in this debate.

Mr. LUETKEMEYER. So, is that a yes or a no?

Mr. DATE. State law issues and solutions ought to, I suspect, be an important part of the solution. But I don't think that somehow excuses the Bureau or other Federal regulators from trying to improve what today appears to be a broken market.

Mr. LUETKEMEYER. Okay. Thank you very much.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you. Mr. McHenry for 5 minutes.

Mr. MCHENRY. Thank you, Chairwoman Capito.

Mr. Date, in connection with this loan servicing issue, has CFPB proactively reached out to the State attorneys general?

Mr. DATE. With respect to the mortgage servicing settlement conversations, I assume, Congressman? At the invitation of the Treasury and the Secretary, we have been asked to participate in the interagency Federal and State dialogue in that way.

There are 50 State attorneys general. Although I don't personally know, I would expect that some reached out to us and that members of the team reached out to some of them.

Mr. MCHENRY. Okay. And in connection with this loan servicing issue as well, has the agency proactively reached out to loan servicers?

Mr. DATE. Just to clarify, with respect to the attorneys general, the CFPB will have an enforcement division. And in an effort to make sure that we are at some level coordinated with State attorneys general, I know that we have, at least, been trying to connect with State attorneys general over time, in respect with their significant authority over these areas.

But that is a more broad-based comment than mortgage servicing.

Your comment with respect to reaching out to mortgage servicers, my job, just a component of it, is to make sure that we are very plugged in to how it is that these businesses, as a practical matter, actually work in the moment.

And what that means is that it is incumbent on me and it is incumbent on my team to make sure that we are connecting, I would hope on a regular basis, with those who can provide market color and market insight.

As the gentleman pointed out a moment ago, the mortgage servicing market has come to be quite concentrated. And so my expectation is that members of my team, if not me personally, have talked with the institutions that have mortgage servicing platforms of some sort.

Mr. MCHENRY. Okay. In light of that, is it part of your practice, in terms of your engagement in this mortgage servicing settlement issue, to float ideas with the industry to see if it is workable?

Mr. DATE. In general, that has not been the approach. What we have tried to do is to provide advice to Federal and State agencies that are at the table.

I would argue that it would become confusing and slightly entropic to be making some parallel set of negotiating rounds with servicers. And so, that is not something we have done.

To be clear, I have tried—I have personally tried to provide ideas to our sister agencies and to State attorneys general, to put those ideas in perspective, those perspectives in some grounded analysis, to communicate that analysis and to listen and receive feedback with respect to—and provide feedback about ideas. All of that is certainly true.

Mr. MCHENRY. Okay. So, that is in light of the PowerPoint presentation that has been going around for a few months now, that some proactive solutions that the CFPB is proposing as a part of this agreement.

Do you have an email from Richard Davis at U.S. Bank to you and Ms. Warren, from back in March, where it appears that it is a follow-up from a conversation? You are asking about details of a needs test.

And so, I just want to be clear, sometimes you are soliciting opinions from the mortgage servicer on what would be workable? I just want to make sure that I give you another opportunity to answer that question. Perhaps I didn't word it correctly.

But it appears, in light of the email that we have—we are not privy to your conversation you had with U.S. Bank. But in response to that meeting, they go through a detailed analysis of what a needs test would look like and how operationally it worked.

Is that something that you solicited?

Mr. DATE. Congressman, I can't recall this specific conversation with Mr. Davis around the—I remember the meeting, of course. But I want to make sure that I understand your question.

A needs test is one of, frankly, many structural mechanisms that a variety of mortgage servicers use in order to prevent what otherwise can be an arguably pernicious impact of moral hazard when loss mitigation techniques are used.

And as a large mortgage servicer, I would expect that particular institution would have some experience in that, particularly in light of delinquencies in the marketplace. And I naturally, by virtue of my role, would be very interested in their perspective and—

Mr. MCHENRY. So you did solicit their opinion on that?

Mr. DATE. I have solicited. I don't remember that in particular, but it would not surprise me. I have solicited opinions about a great many things with respect to the mortgage market and otherwise.

Mr. MCHENRY. Okay. Thank you for your testimony.

Chairwoman CAPITO. The gentleman's time is expired.

Mr. Duffy, for 5 minutes?

Mr. DUFFY. Thank you, Madam Chairwoman.

Just to revisit an issue that came up earlier, there was quite a bit of conversation earlier in this hearing about Ms. Warren. And, I think one of our concerns is that she has come into this committee and told us very specifically that she was here just providing advice for certain folks as her role with the formation of CFPB.

But as we have come to learn, I think she has been less than forthright, that she has been actively engaged in the negotiations, actively making proposals for these settlements.

As one of my Democrat colleagues mentioned earlier, sunlight is the best disinfectant. And when we feel like there has been a cloud around what she has been doing, that will raise our need to question further. And I think that is what has been happening here.

But with that clarification, Mr. Date, is it fair to say that the CFPB is making recommendations that we should have some form of principal write-down as a settlement proposal?

Mr. DATE. We have provided ideas and perspectives on mortgage servicing broadly. I personally had—

Mr. DUFFY. That is not my question. Have you guys provided ideas that a principal write-down should be part of the settlement?

Mr. DATE. That is an idea that we have presented in the past.

Mr. DUFFY. So you have set out the idea that principal write-down could be part of the settlement?

Mr. DATE. As part of a broader settlement.

Mr. DUFFY. Are you aware that the Senate and the House last year considered the concepts of principal write-down? And they soundly rejected those ideas?

Mr. DATE. Congressman, I wouldn't be able to point to specific provisions that were considered or not. But obviously, that was not in the context of a voluntary settlement by parties.

Mr. DUFFY. Sure. But you are aware that it was considered last year in the Senate when we talked about bankruptcy judges being able to do a principal write-down as part of a bankruptcy?

And then in the House, there was a measure to allow mortgage cram-down that was rejected. Are you aware of that?

Mr. DATE. I am not specifically aware of the specific contours. But I do know that the Congress appropriately is thinking about and considering different ways in which to help American households through what is a grotesquely difficult period.

Mr. DUFFY. That is right. And so, the Congress has rejected these ideas. But here at the CFPB, even though we, the elected Representatives of the people of the United States, have rejected it, you all come in and said, as a form of a settlement, as per the documentation that was provided to you earlier by Mr. Bachus.

You say, no, no, no. This is an appropriate form of settlement, even though we have all rejected it, and we are the ones who are the elected officials. I take some offense to that because I think, in the end, what it does is it is going to drive up interest rates. It is going to drive capital out of the private marketplace.

And in the end, it is not going to serve consumers in my district. I think it is going to make it more difficult for them to obtain a mortgage for a new home.

Ms. Williams, as you have been dealing with this issue, is it fair to say that the Federal Reserve and the OCC have been discussing the deficiencies in the servicing process over the last couple of years?

Ms. WILLIAMS. The OCC, the Fed, the FDIC, and the OTS—this has been a subject of interagency discussion.

Mr. DUFFY. And is it fair to say that you guys have entered into consent orders with the Nation's largest mortgaging services?

Ms. WILLIAMS. Yes, sir.

Mr. DUFFY. Yes. And part of that consent order is that there would be significant remedial steps taken to make sure this doesn't happen again?

Ms. WILLIAMS. Absolutely.

Mr. DUFFY. And so, you have stepped in. And I hope that you would have taken appropriate caution to make sure this doesn't happen again. Do you then see the need to have the CFPB and the State attorneys general stepping in to supplement the remedies that you have implemented?

Ms. WILLIAMS. The settlements that the State AGs and the DOJ are involved in deal with areas that are separate and distinct from the areas that we addressed in our orders. They deal with matters of State law. They deal with other Federal agencies' issues.

So, we have moved on parallel and coordinated tracks, but it is a separate track.

Mr. DUFFY. But the concern for everyone here is that there have been some deficiencies in the servicing process, right?

Ms. WILLIAMS. Yes, sir.

Mr. DUFFY. And you wanted to make sure this doesn't happen again, right, moving forward?

Ms. WILLIAMS. That is correct.

Mr. DUFFY. And you have implemented procedures to make sure that doesn't happen again

Ms. WILLIAMS. We are in the process of doing that. Yes.

Mr. DUFFY. Okay, fine.

I am out of time. I yield back.

Chairwoman CAPITO. The gentleman's time has expired.

The first panel—I believe we have had all the questions—is dismissed.

I would like to thank the first panel very much. You had great testimony and great responses to questions.

Thank you very much.

At this time, I would like to call up our second panel of witnesses. I ask everyone to take their seats.

Hello. Welcome to the second panel. I will introduce them individually for the purpose of giving a 5-minute statement.

Mr. David Stevens is no stranger to the Financial Services Committee room. And I welcome him back in a different capacity, as president of the Mortgage Bankers Association.

Welcome.

STATEMENT OF DAVID H. STEVENS, PRESIDENT AND CEO, MORTGAGE BANKERS ASSOCIATION (MBA)

Mr. STEVENS. Thank you, Chairwoman Capito, Ranking Member Maloney, Chairman Neugebauer, and Ranking Member Capuano for the opportunity to testify today on mortgage servicing and national servicing standards.

We at MBA believe that a consolidated national servicing standard, if developed in a cooperative manner, could stimulate much needed reform of a residential mortgage loan servicing system that has admittedly failed a great number of consumers during the recent foreclosure crisis.

In 2008, we faced a "perfect storm." As the global economy collapsed, the subprime market imploded. Many Americans lost their jobs and millions of Americans defaulted on their mortgages, putting extraordinary strains on the existing servicing system.

When the crisis hit, I was in the private sector running a large real estate firm. I saw firsthand the buy and sell sides of the business grind to a halt. All the members of these two subcommittees know from your own experiences the devastating impact that ensued.

It is clear that the real estate finance industry as a whole was unprepared to handle these unprecedented events, and that mistakes were made. What brings us here today, and what is grossly lacking at every level within the industry, is trust.

There is a lack of trust between borrowers and servicers. There is a lack of trust between servicers, regulators, the State attorneys general, and the courts to find a joint solution as to how to equitably handle borrowers facing foreclosure. And there is a lack of trust between investors, underwriters, and credit rating agencies to restore private capital to the mortgage market in a meaningful way.

Without the trust, the housing industry goes nowhere. And by trust, I mean the ability of policymakers, borrowers, and the industry at large to have faith in the products and services we provide, and how those loans will be serviced. It must do better moving forward.

I am here today representing an important segment of the mortgage finance market. In my prior job as FHA Commissioner, you may recall that my staff and I worked hard to get bipartisan support for FHA reform last year. That proposal passed overwhelmingly in this House.

Now here today, I believe the environment exists to reach similar consensus amongst regulators and stakeholders regarding national mortgage servicing standards. Certainly, the MBA will support such an effort.

I can assure you that the mortgage finance industry and servicers have not stood still and we are constantly in the process of addressing our shortfalls in implementing new program upgrades.

Creating a truly national servicing standard would streamline and eliminate many overlapping requirements, providing clarity and certainty for servicers, borrowers, lenders, and investors alike.

It is critical that all of the Federal regulators involved act in a coordinated manner to establish one national consolidated servicing standard that applies to the entire industry, rather than each piling on requirement after requirement.

A national standard should start with a complete analysis of existing servicer requirements and State laws governing foreclosures. Development should include an open dialogue with stakeholders in the servicing arena, all of whom must ultimately work together to ensure the standard achieves the dual goal of better serving borrowers while allowing for a sustainable mortgage servicing business model.

MBA actually initiated the process in January by convening a blue-ribbon council on Residential Mortgage Servicing. That council examined the entire servicing model and is the basis for work that is currently under way to identify recommendations to improve the system for all stakeholders.

In May, the council released its preliminary White Paper. In it, the council examined the current servicing model, educated the public on the role and compensation of servicers, and addressed popular misconceptions relating to servicing practices and incentives.

I believe this White Paper has provided useful information to you and other policymakers that are currently engaged in the debate, and I encourage your two subcommittees and Congress to use MBA and its counsel as a resource going forward.

In conclusion, as we develop servicing standards, I urge you to pay careful attention to the interdependence of servicing and the impact that changes to the system will have on the economics of mortgage servicing, tax and accounting rules and regulations, and the effect of the new requirements on Basel capital requirements and the TBA market.

Servicing does not exist in a vacuum. Instead, it is part of a broader interdependent and interconnected ecosystem that involves all the varied elements of the mortgage industry. The housing market remains fragile. Therefore, when considering changes to the current model, policymakers must be mindful of unforeseen and unintended consequences that could ultimately result in higher housing costs for consumers and reduced access to credit.

I have spent more than 30 years in this industry. Despite what we have just lived through, and the challenges we continue to face, I am optimistic that we can successfully address the challenges in the mortgage servicing system.

To both subcommittees and the full Congress, I would reiterate that MBA supports reasonable national servicing standards that apply best practices to the process to better serve the needs of borrowers, servicers, and investors alike.

Again, we want to be part of the solution and we look forward to working with you and other policymakers towards that end.

I look forward to any questions. Thank you

[The prepared statement of Mr. Stevens can be found on page 106 of the appendix.]

Chairwoman CAPITO. Thank you.

I would like to introduce Mr. Michael Calhoun, the president of the Center for Responsible Lending.

Welcome.

STATEMENT OF MICHAEL CALHOUN, PRESIDENT, CENTER FOR RESPONSIBLE LENDING (CRL)

Mr. CALHOUN. Thank you, Madam Chairwoman, ranking members, and members of the subcommittee, for this opportunity to testify today.

It has been noted what a critical time this is for the housing market. And the housing market is increasingly probably the most important drag on our recovering economy. For the point on that, housing starts today are at the lowest point that they have been at since World War II.

We have an overhang of housing in the real estate market that will take far more than a year to clear—that is, existing houses for sale—without the addition of the many other houses that face foreclosure now.

CRL comes to this and other consumer financial issues from a dual viewpoint. We work to help families achieve and maintain financial security in two ways.

First, we fight for consumer protection that helps families have access to sustainable lending. And second, through our affiliates, we provide, through this affiliate, substantial financing, over $6 billion to date, primarily for homeownership.

We currently, today, have a large portfolio of loans for which we have 100 percent of the credit risk, that we are wrestling ourselves with these very issues of how do you sort out which families can be helped, and which ones need to transition to the next stage.

And so, we deal with this in a very real way on an every day basis.

I appreciate the opportunity to testify today with David Stevens and the work we do with the MBA.

There are three main points. The first is documented by the regulator's repeated studies. There are serious servicing deficiencies and they continue. Importantly, these harmed not only borrowers, but also investors, surrounding property owners, local government, and the overall economy.

Second, there are deep structural barriers to a properly functionally servicing market. As noted, borrowers do not select or control the servicer. Investors, likewise, have very little control over selecting or controlling the servicers.

And perhaps most important, typically, the servicer does not own the loan that they are servicing. They are doing it for another party. That changes the incentives.

And indeed, often, the servicers have conflicts of interest, in that they own second loans and unsecured loans that are subordinate to the very loans that they are servicing, and can be adversely affected depending how they service those loans.

There have been questions about what has been the impact of the servicing deficiencies. And I think it is critical to remember the same company, the same personnel who have been charged with the robo-signing, cutting corners, and inadequate staffing foreclosure, are the very same companies, the same personnel who have been responsible for implementing loss mitigation efforts, have been where the rubbers meets the road of processing which families can be saved and which should be moved forward.

And I think it is noteworthy that the largest legal action to date regarding servicing deficiencies was brought by investors who felt their investments were being damaged by the inadequacy of the servicing, and that too many families were being pushed into foreclosure rather than through loan modification.

And indeed, the remedy in that proposed settlement is that the servicing for troubled loans be transferred to another servicer. In effect, we are trying to figure out how you make servicers treat other people's loans like they do their own.

The solution, as we outlined in our testimony, is better baseline servicing standards and coordinated oversight. Key among the particular individual protections, there needs to be required loss mitigation evaluation before foreclosure can be either initiated or continued.

As noted by many, we need to get in place promptly a single point of contact, so people don't get lost in the maze of these servicing companies.

There needs to be third-party review of loan modification denials. Audits continue to show very high failure rates and error rates by the servicers. And again, this provides the safeguards and improves the quality of the modifications.

And there need to be standards for imposition of fees. Often, borrowers start with a small delinquency and are buried under an avalanche of pyramided fees that push them into an unrecoverable delinquency.

Again, in summary, everyone who is affected by this housing crisis and the key role of servicing in it, we need to move forward with coordinated common sense ground rules and careful oversight, to restore the health of the housing market and our economy.

Thank you.

[The prepared statement of Mr. Calhoun can be found on page 72 of the appendix.]

Chairwoman CAPITO. Thank you. I would like to thank you both. I would like to recognize myself for questioning.

Mr. Stevens, I would like to ask you about something that the first panel got into quite a bit, and that is the mandatory principal modification write down.

How do you feel about that? Do you think that will help solve the problem? Is there a fairness quotient? How do you decide how much, in which direction, and what harm?

I would just like to hear your comments on that.

Mr. STEVENS. So, as briefly as I can, when I was FHA Commissioner, we introduced the FHA Short Refinance Program, which was a program created to provide principal write-down, but it was optional.

I believe mandatory principal write-down is extraordinarily problematic for a variety of reasons. One, it will have a direct impact on future liquidity being provided from this mortgage finance system which desperately needs private capital to reengage. If there are concerns that, down the road, agreements made in pooling and servicing agreements could suddenly be changed at some point, with principal write-down being thrown in as a mandatory provision at awkward moments in economic cycles, the willingness for private capital to reengage will be problematic.

The second reason why I am not in favor of mandatory principal write-down, but do favor, again, optional principal write-down, is that the critical component during this crisis was people's ability to afford their home. In some cases, they may not be able to afford the home without principal write-down. And the servicer and investor combined should take a look at that particular borrower's need, and use that if that is the best solution, based on their determination.

But if forced principal write-down were to occur, it could encourage strategic defaults of people who can make their payments, took a prime mortgage, knew what they were getting into when they bought the home, and simply because of property value loss, they want the investor to take that loss.

And so in each case, I think we need to look at the broad spectrum of loss mitigation options and work primarily towards finding the best resolution, whether it be forbearance, principal write-down, payment reductions or payment modification programs that are provided for in HAMP, proprietary modifications, all of those components.

And that is just the tip of the iceberg, not going into the GSE solutions, the FHA solutions, or the private market solutions.

Chairwoman CAPITO. Thank you. Mr. Calhoun, you wrote a letter, I believe, asking the regulators to withdraw their consent orders, and saying that you think the States were better positioned to make these decisions. Could you give me some background on that or clarification, please?

Mr. CALHOUN. Certainly. As set out in our testimony, and I think this follows the comments of Ms. Williams, we believe that you need a coordinated approach from the Federal banking regulators, the State attorneys general and State banking regulators, as well as the CFPB.

As also as Ms. Williams—I was on the panel with her some time ago when she made the point even more explicitly. The State attorneys general are investigating State law violations. They are not Federal statutes that they are acting under.

And we believe, first, in general, in the preservation of State rights and the preservation of enforcement of those State responsibilities by the State AGs.

We certainly have been supportive, in our testimony today and other times, of the need for the Federal regulators to also have a baseline of servicing standards. But in terms of resolving those State claims, we believe it is appropriate for the State attorneys general to take the lead on that.

Chairwoman CAPITO. Okay. Thank you.

One of the points I think that has been made and the servicing standard suggestions have been the singular point of contact, individual point of contact. Boy, that sounds great.

But can you really get it done when you are talking about servicer moves to servicer? Who is in charge? Who is on first? Who is on second? We all like to have the day where you really just had to walk down the street and talk to your local mortgage guy and say, “I am going to be a little late this month. Can you help me out here?”

I talked to Ms. Williams about this previously. Is that achievable? As much as I think it is great and we should do it, is this workable? And what kind of suggestions would you make to make it workable, so that when somebody has a problem, they actually have somebody that they can impact. and they are not stuck with, “push one for this, push two for that, and call back in 24 days.”

Do you have any suggestions? I don’t have much time, but how might that work?

Mr. CALHOUN. I think, as you know, it can make a lot of progress where we are now. There are some debates. Some of the servicers are already going to a goal of a point a contact, to make sure that if you have a problem, you can call and get a live person who has access to all your information, not somebody who is just writing down a note to pass on to someone else.

And that, at least as the minimum, should be there. And hopefully, the goal is actually there is a case manager.

The loan modifications are very akin to re-underwriting a loan. And in that process, I think it is noteworthy that the servicers typically do have a single underwriter assigned to underwrite the loans for the original making of the loan.

And so, I think that suggests that there is a lot of wisdom in having that same process when you, in fact, are re-underwriting the loan for purposes of the loan modification.

Chairwoman CAPITO. Yes. I would agree with that. And I think that what we have found here is that the servicers did not have the staff available, didn't anticipate, I don't think, the numbers and the complexities of where we were going to be. Hindsight is always better.

So, hopefully, this will help with that, because I think that is a very valuable point of a national servicing standard, if that is the direction that we end up going, which it looks like it is.

So I will recognize Ranking Member Maloney for 5 minutes.

Mrs. MALONEY. My main question is, how do we prevent this from happening in the future? And is the consent agreement that has come forward from the regulators—is that strong enough? Or what changes need to take place so that we prevent this disaster to individuals and our overall economy from happening again?

I would like to start with Mr. Calhoun, then Mr. Stevens. In what way does the consent agreement fail to provide sufficient accountability for servicers, either in their foreclosure procedures generally or in their loan modification or loss mitigation efforts?

And I would also like you to comment on the point that my colleague, Mr. Perlmutter, raised, where the servicers come in and they say to the bank, "Oh, we are not going to charge you anything. We will handle it for you."

Meanwhile, they contract with the lawyers who are paying them, that they have obstructed the lawyer-client responsibility, where the lawyer must look out for the best interest of their client. And maybe that has cost this country more, in terms of what it is costing us individually and as an overall economy and government to respond to this.

If an attorney-client relationship was there, where they were really forced to look at every option and work with that individual, but it is cut off. And if I understood him correctly, the attorneys then are pressured, don't ask questions; just pay us and get it done.

And maybe it would have been better if there were able to have that communication and that responsibility, and to ask those questions on the individual basis of how to best work through it, both for the individual and the country.

Starting with you, Mr. Calhoun, and then Mr. Stevens.

Mr. CALHOUN. I think the first point is that the best way to avoid this, again, is—and I think we are making great progress on this—strong but workable mortgage origination standards, so that we are not flooded with portfolios where you have 50 or 50-plus percent of the loans going to foreclosure. It can be very difficult to design a system that can absorb that.

We have worked with the MBA, for example, on concerns with the qualified residential mortgage standards. We are very concerned at CRL about access to credit. We think that is a huge thing. But specifically, you need some bright line ground rules because of the structure of this market in good times.

These structural problems have been there. They were masked by the bubble housing economy of 2000 to 2006, when the securitization and a lot of the structure grew up. Default rates were so low and they were illusory low, because people, in point of fact, were defaulting, but instead they could get an easy refinance. And there really was a buildup of the foreclosures.

But you need more specificity, so that there are basic ground rules that then the system can operate competitively with.

Mr. STEVENS. I would completely agree with the statement about strong, well-founded, secure origination practices being the first bellwether to protect this environment from ever occurring again.

If we all reflect back, we had an industry that was designed for efficiency over the last decade. It became fully automated only in the late 1990s. So we didn't even have automated underwriting systems until the 2000s that were actually been using in this country.

All the processes of servicing became based on efficient, low-cost, low-touch, highly technologically-oriented servicing systems that could work efficiently for performing loans.

When the bubble collapsed, the models had never been tested. The automated systems had never been through this, a testing of a market correction. When the house of cards completely collapsed, these low- cost, low-touch, efficient servicing models found themselves completely incapable of dealing in what was now needed to be a high touch, a highly trained, extraordinary set of underwriting skills, a personnel base that just absolutely did not exist.

The servicers were not prepared for this. The capital had already been expended. The market was not prepared for the extraordinary collapse of these models that proved to not be able to withstand the pressures of an economic downturn, no matter how they were viewed when the loans originated.

And that subsequent collapse has created all of this backlog, the extraordinary pressure on all of our systems in our economy, that could be avoided going forward if we had strong rules about performing loans.

This is the last point I would make. If you look at prime owner-occupied residential loans originated by the GSE's fully documented, the default rate is only about 5 percent. It is high, but it is extraordinarily low. And had we stuck to those kinds of underwriting characteristics, we wouldn't have found ourselves anywhere near the predicament we are in today.

Mrs. MALONEY. Thank you.

Chairwoman CAPITO. The gentlelady's time has expired.

Mr. Renacci, for 5 minutes for questions.

Mr. RENACCI. Thank you, Madam Chairwoman.

It is interesting, because I am still hearing you say that if we had all the procedures and all of the things in place in advance, this would not have happened. Even going into the future, I think I heard you just say that, Mr. Stevens.

And my concern is even if they are in place, you are always going to have issues going forward. But I also heard you talk about personnel. Do we have the personnel? Are we going to have the servicing agencies? Are they going to be available with the personnel and the opportunities for another major downturn?

I am not talking about one that happened in 2007, 2008. But, what are we going to do to make sure those things don't occur in the future?

Mr. STEVENS. I really believe that is the discussion that we are all actively engaged in, and my worry in the process today is that we are so concerned about coming up with a perfect answer in the current moment, that we see, again, multiple sets of rules and regulations coming out of the various regulators, some untested ideas—even single point of contact, for example, is not really tested.

It is now being required in HAMP, but we don't ultimately know if that is the right solution.

Independent servicers has been a proposal. We don't know if independent servicers can ultimately handle the volume.

My contention is that if we go back decades in the industry—and I started in this industry in Colorado—yes. And we all know Mayor McNichols lost his job because he didn't have enough snow plows for the big snow storm, yet he had enough plows for normal sets of snow storms.

We will go through market corrections. In Colorado, they also experienced the oil patch crisis. And during the oil patch crisis, we saw market corrections. And there were home value declines. And there were large numbers of foreclosures.

I was personally in the industry at that time. We were able to manage it because we hadn't built on top of that this extraordinary bubble of unsustainable mortgage products, given to people who never should have qualified for that product in the first place, created this frenzy around using their home as an ATM machine.

And I do believe when we come back to it—and we will go through market corrections again, there is no question about it.

If we can create safe and sustainable guidelines for mortgage products, and we can create a standardized set of servicing requirements that protect the consumer, but also provide for an industry that can actually deal with these crises, I think we will come a long way to creating an environment that will allow us to withstand the storms of the future.

And I think that is the most important thing we need to be prepared for.

Mr. RENACCI. Mr. Calhoun, do you have any comments?

Mr. CALHOUN. I think your point is well taken, that there need to be basic protections and quite frankly, some basic rights for consumers. I am sure you had constituents who called their servicer and they were basically at the mercy of what the servicer decided to do, for example, with imposing fees, with how they treat their payments, etc.

In the absence of the rules, we should expect that. So what happened was servicing companies pay the originator of loans to get the right to service the loans. And then again, they get paid a monthly fee, typically 25 basis points for a GSE-type loan.

And they are supposed to make the money back through that fee and through the additional fees that are charged, because they get to keep the late fees, the property inspection fees, the third-party vendor fees.

Without standards there, companies who can charge a lot of those fees are going to bid up the price of the value of servicing. And so, if you want to be in that market, you have to match what they are doing. If you are allowed to charge those fees and everyone allows it, that is the only way you can stay in the market.

So we need that baseline of—and I think we are close. There can be areas of disagreement. But there is evolving consensus of what the contours of that baseline of protection should be.

We need to get those in place. And then at the other side, investors are now much more attuned to making sure that they have more protection about servicing and start to insist on protection in the securitization field, when up to now, no one even thought about that when they were doing due diligence on a security.

Mr. RENACCI. Mr. Calhoun, how would you protect consumers from illegal mortgage servicing in the future, the illegal things that have occurred, some of the ones that have occurred?

Mr. CALHOUN. I think the CFPB will play an important role in this, because you need the flexibility to respond to the changes in the market. The CFPB needs to be careful to not throttle innovation, to not adversely impact credit, which I think for the next probably—

Mr. RENACCI. Excuse me, not to interrupt, but how is the CFPB going to do that?

Mr. CALHOUN. Under Dodd-Frank, it transferred those specific statutory responsibilities for servicing under RESPA. It also is given a general mandate to oversee the servicing companies, along with the Federal banking regulators, and to police and prohibit any unfair deceptive practices by the servicers.

Mr. RENACCI. I know I ran out of time, but I was really trying to get to the specifics.

Mr. CALHOUN. Forced-place insurance is a big thing, where the servicers will place insurance with a company that the owner has interest in, and charge the borrower 3 or 4 times what the regular insurance rate is.

Chairwoman CAPITO. The gentleman's time has expired.

Mr. Perlmutter?

Mr. PERLMUTTER. Okay. And again to follow up on my colleagues' questions—and first of all, thank you two for being here. The wisdom you are bringing to the table is really important.

In Colorado, I would say, though, having done the foreclosures during that period when our economy fell apart, we, as the lawyers, did say 10 foreclosures a month, boom, boom, boom. All of a sudden, we were doing 100.

And we weren't ready for it. Okay.

This time around, some guys have been doing 100 foreclosures a month. All of a sudden, they have 5,000 a month. And they can't do it.

So the system has just been swamped, from beginning to end. And it started with some lousy loans being made in the first place.

So you two are right on the money. That is where it starts. But I don't know that any system is going to be foolproof when, all of a sudden, you have this giant lurch in the numbers that are being processed. Because we are going to go back to some normal at some point here. And then we will deal with it.

And then there will be another downturn. And for a while, there is going to be a backlog.

But what I don't want—and I want the servicers or whoever is processing these things to do them, to do them in a speedy fashion. But the real problem here is that the borrower is entitled to some due process. And that is what has been missed in so many of these cases. That is why that robo-signing isn't right.

That is why pushing these out the door so fast, in some instances, because that borrower has rights. The investors have rights. Everybody has rights in this deal. But the borrower's rights were getting hurt in the name of speed.

So, let us go back to some of those things that need to be corrected, whether it is robo-signing or, in my opinion, I think the lawyers are being asked—as they process these things, they have to kick back in effect.

They are paying certain fees back to the servicers that really weren't ever in the deal in the first place. But to get the foreclosure, they have to do it.

So I will let you follow up on Mr. Renacci's question. And if you can answer that and my questions, I would appreciate it.

Mr. STEVENS. Let me just try just a couple, the robo-signing, where, in fact, the laws were violated—robo-signing became a big catch-all phrase. But where, in fact, affidavits were signed by people who are not the individual who was actually supposed to sign, or could not support the attestations being made in that affidavit, because they hadn't reviewed the subsequent documentation, those are legal violations.

And those are fully enforceable. So, to some degree, I think what we found during this process of this collapse is in the effort to respond to this massive pile of foreclosures, people were setting up the proverbial, as the stories would call it, card tables with Burger King kids, which was the story in Florida, of just untrained, inexperienced people signing off on documents.

All of that is illegal. That is fully enforceable. And that clearly has to change. I still come back to the—

Mr. PERLMUTTER. If I could—

Mr. STEVENS. Yes.

Mr. PERLMUTTER. I guess that is what I am trying to say. Here you have these massive numbers of foreclosures coming through. Everybody is trying to deal with it. There are plenty of laws in place to go after a lot of these practices.

I would caution the regulators as they get involved in this to not go overboard.

Mr. STEVENS. Right.

Mr. PERLMUTTER. We had something—there is a huge swamp of the system. So, go ahead and finish. But I agree with that point.

Mr. STEVENS. So if you take that at its premise, there were laws broken by not all institutions but some. Those cases are being fought either through State attorneys or through class action lawsuits or other measures where people are paying fines. Some are going to jail. Many institutions have failed in this process, because they were not legitimate.

So that is one core measure that exists anytime crimes are committed. There are other provisions that exist today. And I think

FHA is actually a good example. FHA has had in state, in their processes as a requirement, by rule and by statute, a set of servicing standards that must be complied with. Even the OTC consent decree references the FHA as a model for how you set up servicing centers.

What we found through this last cycle was that not all guarantors of risk, not all institutions that paid out servicing fees to companies that service their loans had the same set of standards. They vary significantly. Even Freddie and Fannie had different sets of standards that weren't completely in sync.

But the FHA sets of standards also came with explicit penalties for noncompliance, which could, at bare minimum, include nonpayment of claim, meaning your loan is not insured and you take the full loss on that loan if you don't service it appropriately.

Mr. CALHOUN. Dave, could I add—

Mr. STEVENS. Yes, go ahead.

Mr. CALHOUN. —a couple of specifics there. The first is how your payments are treated.

One of the real scams that goes on is say, you make a payment that there is a late fee taken out, or your payment is $50 short. Many servicers now, instead of crediting you—should have paid $1,050, you paid $1,000; instead of crediting the $1,000, they put it in something called the suspense account, meaning you get no credit for it.

The account is treated is if you made no payment. And so interest accrues as if you had made no payment. Penalty accrues as if you paid no payment.

That should not be allowed. There should be prompt and full crediting of all your payments.

All the junk fees that get piled on, that has been the business model, if you are a servicer, of how you make this possible, is you just pile on the jump fees. If people are late, they ought to pay a reasonable fee.

I think much like what was done with the Card Act, where for credit cards we had no basic ground rules and we saw all these abuses and games come up. Put in a set of basic ground rules and then let the market compete.

You didn't set credit card interest rates, appropriately so, as the focus of that bill was on the basic ground rules. So let the companies compete on service, benefits, and the fee, and their interest rate, but don't let them have all these under the table, things that people can't shop on and make the market not work.

Chairwoman CAPITO. The gentleman's time has expired.

I am going to go to our last question, because we are going to be having a vote and, if we can, we will come back.

Mr. Manzullo, for 5 minutes.

Mr. MANZULLO. Thank you very much. I am going to date myself, because I was practicing law when RESPA came into effect, and we had to back-date the documents 3 days in order for the homeowner to buy the house. I used to be able to close a real estate loan as an attorney in 20 minutes, with a stack of papers maybe the size of my thumb. And now it is 2 hours and there are so many disclosures, there are so many protections out there, no one knows what goes on.

If they think it is bad in housing, any of you who are making payments on a student loan, look at the national organization that really screws that one up. They hang up on you. They put things in a suspension account. They scream at you. You can't pay in advance. There are a lot of problems there.

But what I wanted to return to is the fact that when I was first elected back in 1992, shortly thereafter, somebody came up with the brilliant idea to bypass recording home mortgages with a local recorder, something called MERS. That is the reason now where we have a lot of people who don't know who owns the notes. They don't know who owns the mortgage.

And so, in all those great automations to make things easier, to standardize things, things got worse. It is almost to the point where there is no longer, with the exception of many community banks, any type of face-to-face contact.

And oftentimes, the only real people that the homeowner will see is the community bank that originated the loan, sold under secondary markets and maintains the relationship of collecting the payments. And it is obvious that relationship must exist. Otherwise, local homeowners absolutely have no idea as to whom to contact in the event that there has to be something taken care of.

The second thing is in the FHFA extended the timeframe within which a mortgage has to be foreclosed. But the problem that we see is every State has its own mortgage foreclosure. In some States, it is an administrative function that doesn't even go through the courts. In the State of Illinois, it is a formal legal proceeding with the equity of redemption and everything rolled into it.

I know what you are trying to do. And I know what you are advocating. The problem is that that you are advocating common sense. And that is never going to find its way into anything that makes sense coming out of this City.

Isn't there a way, for example, of coming out when a loan is originated, that there are 10 principles that can be followed that would add to the stack of papers I guess that the homeowner would get, that would talk about exactly what is expected of when the person makes the payment?

Could that be adopted as a standard of the industry as opposed to, in fact, allowing the Consumer Financial Protection Bureau to come up with some more standards?

On page five of your testimony, Mr. Stevens, you say, "Unfortunately, each of the parties mentioned has a different opinion on what the servicing standards should be, making it very difficult for a servicer to implement what has already been issued."

Mr. STEVENS. I think you are highlighting the extraordinary complexity to this process and the concerns that we have about creating more confusion, rather than finding a solution to protect consumers.

We are moving in that direction, to come out with what we believe could be an industry response. And we are moving as rapidly as possible, so as to hopefully contribute to what ultimately we could get others to join in with us to get to that solution.

The point that I would continually emphasize is that our industry desperately believes that we need a solution to create servicing standards, but that we need to change the perspective that there is some value creation in doing it badly. Servicers have paid an extraordinary price for the mistakes of this broad industry and the crisis that we have just been through.

Even these partial payment applications, the servicer must redeem a full payment to the investor every month, whether the consumer makes no payment or a partial payment. And a consumer who decides to be constantly late by choice and continues to make partial payments, I think the question ends up being asked, should the servicer have to pay the brunt of that continuous delinquency in the process.

All of these are very complex questions, which is why what I said in my testimony and we continue to advocate for, we need to work collectively and aggressively to try to conclude with a national set of servicing standards that can be adopted to protect consumers, to reach our objective, but not to overreach and create a system that is just nonfunctional for either the industry or the consumer, or for capital to engage back in the system.

And I will pledge to you that the mortgage bankers are moving on that path. We already have started down that path and we hope to have something—

Chairwoman CAPITO. The gentleman's time has expired

Mr. STEVENS. —to talk about here at the short-term.

Chairwoman CAPITO. Mr. Neugebauer for 5 minutes.

Chairman NEUGEBAUER. Thank you, Madam Chairwoman. The first thing I would like to do is ask unanimous consent to offer material that I used during my questioning this morning for the record.

Chairwoman CAPITO. Without objection, it is so ordered.

Chairman NEUGEBAUER. Thank you.

I apologize, I am kind of bouncing back and forth.

But, Mr. Stevens, one of the things that my friend, Mr. Hensarling from Texas brought up earlier, and maybe others have, is that we need to get the mortgage market back functioning again. And particularly, we need to get private capital back into play here.

I know a number of my colleagues have been sitting down with people who have been in the past participants in the private mortgage market. There is a lot of reluctance, quite honestly, right now for those participants to come back into the market. And particularly, they point to just a lot of uncertainty.

And I think the latest round of uncertainty is now there is this huge proposed settlement that we haven't seen yet. But also that the implications of that in the chain of title and the rule of contract, where servicers are going to be mandated to basically enter into modifications and principal reductions.

Without really a lot of input from I think really the ultimate holders of those mortgages, the investors are buying those mortgage-backed securities. And while obviously having some certainty of what the world is going to look like moving forward, I think the troubling part is that we may have created so much what I call regulatory risk in the mortgage market that is going to cause an increased pricing premium for new risk that is out there that subsequently wasn't there in the past.

Is that a sentiment that you share?

Mr. STEVENS. Congressman, if I could, I would like to separate the settlement discussions going on with the broader question about the regulatory environment and the mortgage capital and I need to do that because of my previous role as FHA Commissioner and that I was with the ethics council prior to leaving, and the servicing settlement discussion is a subject that I cannot discuss and have not been involved in since I became FHA Commissioner at all.

On the broader question, when we created the FHA short refinance program, which has received mixed reviews, those kinds of programs were created with the intention of it being an optional opportunity to write down principal refinancing to a new mortgage.

The uncertainty premium that exists right now in the market is clearly impacting the desire, the inclination of private capital, private market players to come up with private capital, there is no question about it.

There are other things, home prices being flat or declining, that uncertainty as well makes the investors concerned about the collateral they are investing in.

But there is no question that many of the actions that are being discussed or to take place in the future from a regulatory standpoint are going to have extraordinary impact on who invests in the U.S. mortgage market.

One fact we all know is to finance $1.5 trillion of annual mortgage production, sort of a normalized market, we cannot depend solely on the banking system to provide that financial capital and so that will have to come in from external parties.

To do so, we need confidence in the servicing environment. We need confidence in that terms that are agreed to in investor documents will be upheld and that there won't be changes to those documents down the road.

And the more uncertainty we create to this discussion while trying to reach a conclusion to help protect consumers and create a safe market, that has to be in balance to the notion that we need to have a functioning housing finance system going forward or there will be no really functional recovery for a much longer period.

So I do appreciate your concern, and I think it is one that why we are so concerned about making sure that we are all actively engaged in this discussion, regulators as well as private sector participants and the other stakeholders before decisions are made because these all have extraordinary impacts on this ecosystem which we depend on to make the housing market function.

Chairman NEUGEBAUER. Mr. Calhoun?

Mr. CALHOUN. First, I think there is very broad evidence that there are not enough loan modification efforts taking place and that they are not being done well.

As I have made the point earlier, the servicers who messed up the foreclosures are the same ones doing the loan modifications. And indeed, it is the investors who are coming in and demanding, including a legal action, so that there will be more modifications because they ultimately are paying a heavy price.

Second, the touchstone still needs to be net present value, that the modification results in a higher return for the holder of the mortgage or the investor who holds the security. But I do think we can move to a better place and there is broad consensus of the contours of how we do that to get some baseline standards in place and that will help both consumers and the investors which also indirectly helps the consumers.

Chairwoman CAPITO. Thank you.

Mr. Carney, for 5 minutes, will be our final questioner, as we have votes, so proceed.

Mr. CARNEY. Thank you, Madam Chairwoman. I appreciate it. And I apologize to the panel for just coming in a minute ago. I am probably going to ask questions that you may have addressed in your testimony.

But I would like to follow up on really the conversation you were just having about what we need to be doing or what ought to be done to address the problem at large, and in particular, to address the problems that folks in delinquency and foreclosure experiencing.

In my State, the State of Delaware, we put together a group of people that included the banks and servicing agency, the community service organizations that have housing counselors and working with homeowners, the government agencies.

And in my view, it has always been that it requires a whole series of talks. We have had debates in this committee with the other members here about anything else, the government has been the problem, one side argues and, today, we have heard about the problem that the servicers have had.

And it seems like I was frankly appalled to hear about the practices that were not being done. Could you elaborate again on what you were just addressing what we need to really address these problems?

Getting people processed through in my State, we ran into consumers who can't get one single point of contact that is going to get it fixed. The documents get lost. They can't move through the process. Nobody is willing to make a decision.

The HAMP program in Delaware has been very successful. It hasn't been as successful in other States. Could you offer your thoughts on what we should be doing? Both of you, if you would, please?

Mr. STEVENS. I will start. This is the billion dollar question that we really need to be thinking about.

I will cover a couple of points. The HAMP program works particularly effectively obviously with Freddie Mac and Fannie Mae loans. But Freddie Mac and Fannie Mae can't do principal writedown using the FHA's short refinance program.

Private label investors, because of concerns about Safe Harbor provisions, etc., working through trustees, it makes it difficult for a servicer to take action on a certain modification initiative because they could expose themselves to litigation for violating the pooling servicing agreement.

We are in a very complex financial environment, on top of which, as I said earlier in my testimony, I would never want to back away from that, the entire servicing industry has been working frantically to hire tens of thousands of people across this country and train them to be underwriters—the skill that they didn't typically have to have in the servicing world to be able to respond to the enormous need of families across America.

I would be glad to do this as a follow-up. Let me just start at a high level. And this is going to sound extraordinarily limited. But I view the market issues right now as both a supply and a demand struggle.

On the supply side, we have excessive inventory as it were of foreclosures and borrowers at risk, either do the unemployment, causing them to not be able to pay their mortgages or having them put into mortgages that were not sustainable, or strategic default due to the overhang of negative equity. Each of those has a set of solutions we need to work with and systems need to be created.

And then on the demand—

Mr. CARNEY. Do we have those systems?

Mr. STEVENS. I think the system is—there is a lot of—

Mr. CARNEY. And tools?

Mr. STEVENS. Let us talk—

Mr. CARNEY. Every situation is different.

Mr. STEVENS. Let us talk about—let us finish this up and I will turn it over, because it is a long answer.

Mr. CARNEY. My time is running out.

Mr. STEVENS. Look at modification today, about 4.7 million modifications have been proprietary modifications done by financial institutions, the same servicers that we have talked about in this hearing today.

HAMP modifications have been about 700,000 because the proprietary modifications have actually been far more effective as a solution than—

Mr. CARNEY. And that is a good thing.

Mr. STEVENS. It is a good thing.

Mr. CARNEY. It is a good thing.

Mr. STEVENS. But it tells you that it is impossible to come up with a one-size-fits-all solution.

Mr. CARNEY. Exactly.

Mr. STEVENS. And it takes the private sector and these regulators working together to come up with a broad set of solutions and then training expertise—

Chairwoman CAPITO. Will the gentleman yield for 2 seconds?

Mr. CARNEY. Sure.

Chairwoman CAPITO. Following up on your comment that Fannie and Freddie cannot write down loans, do you think they should be able to write down loans?

And I yield back to the gentleman.

Mr. CALHOUN. If I can respond to that?

Mr. CARNEY. Please do.

Mr. CALHOUN. In the broader question, the baseline that needs to be there is you should not be allowed to start or complete a foreclosure unless the servicer can demonstrate that they have gone through a good faith evaluation of whether an alternative loan modification is possible.

Obviously, if the borrower doesn't respond, or the borrower doesn't have the income to make it work, they don't have to modify. But, as you have said, when you get people into the room and you force them to commit those resources, and as we heard from Congressman Scott, it works.

Second, on principal reduction, industry analysts and investors are calling for principal reduction because it generates a higher return than foreclosure, which right now is producing horrific losses. And there are repeated studies, Amherst Securities, for example, shows that currently performing loans, if they are deeply underwater, are rapidly falling into default and foreclosure.

And that is why some servicers have recently published these—added some banks on their portfolio loans are offering principal reduction in carefully controlled ways because it makes sense. Again, we need to force the servicers to treat other people's loans as they are treating their own portfolio loans.

Mr. CARNEY. Thank you very much.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. The time has expired. The Chair notes that some members may have additional questions for this panel, or both panels, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for the members to submit written questions to these witnesses and to place their responses in the record.

I would like to thank all of the witnesses, and I understand some have come from far away, so I appreciate that.

And with that, this hearing is adjourned.

[Whereupon, at 1:37 p.m., the hearing was adjourned.

A P P E N D I X

July 7, 2011

Testimony of Mike Calhoun
President, Center for Responsible Lending

Before the House Financial Services Committee's
Subcommittee on Financial Institutions and Consumer Credit and
Subcommittee on Oversight and Investigations

on

Mortgage Servicing: An Examination of the Role of Federal Regulators in Settlement Negotiations and the Future of Mortgage Servicing Standards

Thursday, 7 July 2011
2128 Rayburn House Office Building

Good morning, Chairwoman Capito, Chairman Neugebauer, Ranking Member Maloney, Ranking Member Capuano, and Members of the Subcommittees. Thank you for the invitation to testify on mortgage servicing and foreclosure mitigation.

I am President of the Center for Responsible Lending (CRL), a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution. For thirty years, Self-Help has focused on creating asset-building opportunities for low-income and minority families, primarily through financing safe, affordable home loans. In total, Self-Help has provided over $5.6 billion of financing to 64,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America. Currently, Self-Help is grappling with many of the same issues encountered by other lenders, including servicer capacity limitations and homeowners who face serious economic challenges. Our testimony today is informed by this experience.

I. Background

Almost four years ago, CRL released a report warning that the reckless and abusive lending practices would lead to approximately two million subprime foreclosures. At the time, our report was denounced by the mortgage industry as absurdly pessimistic. Sadly, the system was even more larded with risk than we reported, and the damage has been far worse, spreading from the subprime to the prime sectors, catalyzing a housing-lead recession, and triggering historic levels of unemployment. Since housing prices began their precipitous decline in early 2007, 7.5 million homes have entered the foreclosure process.[1] Furthermore, the crisis shows no signs of abating, as 8.1 percent of all loans—representing about 4.2 million borrowers—are currently 90 days or more delinquent or in some stage of the foreclosure process.[2] The foreclosure crisis has had catastrophic consequences for families and communities, especially communities of color. A 2010 study by CRL estimated that among borrowers who received their loans between 2005 and 2008, nearly 8 percent of both African Americans and Latinos had lost their homes to foreclosures, compared to 4.5 percent of whites.[3]

It began when millions of homeowners ended up in dire straits owing to abusive mortgage originations, incompetent and predatory mortgage practices, ineffective government oversight, and a complex securitization system that lacked accountability all the way up and down the chain. This "round one" of the foreclosure crisis sparked a broader economic downturn that has resulted in very high levels of unemployment and lost wealth. This broader economic crisis brought about "round two" of the foreclosure crisis. Today, millions more families are expected to lose their homes owing to the toxic combination of underwater loans and unemployment that festers in so many parts of the country.

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[1] CRL calculations, based on Mortgage Bankers Association, National Delinquency Surveys 2007-2011, with numbers adjusted to reflect MBA's estimated 88% market coverage.

[2] Mortgage Bankers Association, National Delinquency Survey 1Q 2011.

[3] *See generally* Debbie G. Bocian, et al., *Foreclosures by Race and Ethnicity: The Demographics of a Crisis* (June 18, 2010), available at http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf [hereinafter *Foreclosures by Race and Ethnicity*].

Servicers engage in a wide range of abusive practices, detailed below, which in many cases lead to unnecessary and sometimes wholly unwarranted foreclosures. The Urban Institute conservatively estimates that a single foreclosure costs $79,443 after aggregating the costs borne by financial institutions, investors, the homeowner, their next-door neighbors, and local governments.[4] However, this number probably understates the full cost, since it does not reflect the impact of the foreclosure epidemic on the nation's economy or the disparate impact on lower-income and minority communities.[5] The effects of this wealth drain are exacerbated by the larger economic downturn, with weakness in the housing sector slowing economic recovery and hampering efforts to create jobs and reduce unemployment.

Although serious delinquencies dropped in the first quarter of 2011, according to the Mortgage Bankers Association (MBA) Mortgage Delinquency Survey, 4.8 million borrowers (one in 11) remain at risk of foreclosure.[6] That is far worse than in the first quarter of 2007, when 1.6 million mortgage holders (one in 33) were at risk of losing their homes.[7]

Unfortunately, the bleak housing outlook is exacerbated by a mortgage servicing system ill-equipped to handle the volume and intensity of demands upon it. As a result, many servicers have failed to engage in reasonable loss mitigation efforts and borrowers have been subject to confusing, abusive, and sometimes illegal practices. My testimony will detail some of the most troubling abuses in the servicing industry and recommendations for basic ground rules that will enable the servicing system to operate more fairly and effectively and help stabilize the housing market.

II. Overview of Mortgage Servicing Abuses

Widespread mortgage delinquencies have laid bare many of the abuses and failures that have existed within the mortgage servicing industry even before the current crisis. For at least a decade, community-based organizations, housing counselors and advocates around the country have documented a pattern of shoddy, abusive, and illegal practices by many mortgage servicers, whose staff are trained for collection activities rather than loss mitigation, whose infrastructure cannot handle the present level of demand, and whose business records are a mess.[8]

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[4] Thomas G. Kingsley, et al., *The Impact of Foreclosures on Families and Communities* (The Urban Institute 2009), available at www.urban.org/UploadedPDF/411909_impact_of_forclosures.pdf.

[5] *Foreclosures by Race and Ethnicity* at 3 ("As the foreclosure crisis threatens the financial stability and mobility of families across the country, it will be particularly devastating to African-American and Latino families, who already lag their white counterparts in terms of income, wealth and educational attainment.")

[6] Center for Responsible Lending, *Delinquency and Foreclosure Trends: Housing Market Remains Shaky – A Bigger Picture Look at the 2011 Q1 MBA Delinquency Survey*, Issue Brief (May 27, 2011), available at http://www.responsiblelending.org/media-center/press-releases/archives/Delinquency-and-Foreclosure-Trends-Housing-Market-Remains-Shaky.html (citing MBA Delinquency Survey for 2011 Q1 with numbers adjusted to reflect MBA's estimated 88% market coverage).

[7] *Id.*

[8] *See, e.g., In re Ocwen Loan Servicing, LLC Mortg. Servicing Litigation,* 491 F.3d 638 (7th Cir. 2007) (allegations by a class of homeowners that Ocwen systematically charged late fees for payments that were sent on time); *Federal Trade Commission (FTC) Settlement* (2003) resulted in $40 million for consumers harmed by illegal loan servicing practices, *available at* http://www.ftc.gov/fairbanks (FTC alleged, among other things, that Fairbanks illegally charged homeowners for "forced placed insurance" and violated the Fair Debt Collection Practices Act); and *FTC Settlement with Countrywide, available at* http://www.ftc.gov/countrywide (Countrywide agreed to pay $108 million dollars to homeowners in

These practices have become so ingrained in the servicing culture that they are now endemic in the industry. The harm to which borrowers have been subjected as a result of these abuses cannot be overstated. Numerous homeowners are burdened with unsupported and inflated mortgage balances or have been subjected to unnecessary and/or wrongful foreclosures before loss mitigation measures have been fully considered. These abuses include the following:

- *Dual track.* Servicers actively pursue foreclosure even when they are already working with homeowners on a modification, often leading to unnecessary foreclosures before a decision on the loan modification has been made.
- *Foreclosing even when investors would receive more from a sustainable modification.* It is in the best interests of investors and borrowers, and a requirement under the Home Affordable Modification Program (HAMP), that servicers modify a mortgage loan when it is net present value (NPV) positive, *i.e.*, when the expected return to investors from a modified loan is greater than the expected return from a foreclosure. Unfortunately, this is not happening systematically.
- *Improper denial and delay of loan modification requests.* Delay is in servicers' interests because fees, which eventually flow directly to servicers (either from the homeowner directly or through the proceeds of a foreclosure sale down the road), continue to accrue. A ProPublica study highlights the problems this creates for distressed borrowers: The homeowners interviewed spent an average of more than 14 months waiting for a HAMP modification (a process that should only take a few months), and "as a result of the delays, homeowners fall further behind, putting them in danger of foreclosure and making it less likely they'll qualify for a modification. About two-thirds of these homeowners were still current on their mortgages when they began the process, but most have now fallen behind."[9]
- *Forcing homeowners into multiple temporary modifications.* All modifications are not created equal. Extended temporary modifications are good for servicers' interests but harm those of borrowers. Temporary modifications can represent a "best of both worlds" situation for servicers, who continue to charge fees as if the borrower is in default but without the cost of having to finance principal and interest advances to investors. Many borrowers go from one temporary modification to another, continuing to accrue high fees that drive them even further underwater.
- *Force-placed insurance.* Servicers too often force-place very expensive hazard or other insurance and charge the borrower's account when the borrower's insurance has not lapsed (or is not needed as may be the case with flood insurance), often driving an otherwise current borrower into delinquency and even foreclosure.
- *Improper fees.* Servicers sometimes charge unlawful default- and delinquency-related fees for property monitoring and broker price opinions.
- *Requiring borrowers to give up legal rights in order to receive a modification.* This is even more egregious considering that some temporary modifications are not in borrowers' interests, making legal rights the only effective bargaining chip for such borrowers to enter

response to the FTC's allegations that Countrywide charged illegal fees to homeowners during Chapter 13 bankruptcy proceedings).

[9] *See, e.g.*, Paul Kiel & Olga Pierce, "Homeowner Questionnaire Shows Banks Violating Gov't Program Rules," *ProPublica* (Aug. 16, 2010), available at http://www.propublica.org/article/homeowner-questionnaire-shows-banks-violating-govt-program-rules.

into permanent and affordable modifications.

- *Misapplication of borrower payments.* This results in inappropriate and unauthorized late fees and other charges, as well as misuse of borrower funds improperly placed in "suspense" accounts, which creates income for servicers.
- *Mismanaged escrow accounts.* Servicers sometimes improperly manage borrower accounts for real estate tax and insurance escrows, including by failing to disburse payments for insurance and taxes on time, causing cancellation and then improper force-placing of insurance, as well as tax delinquencies and tax sales.
- *Failing or refusing to provide payoff quotations to borrowers.* This may prevent borrowers from obtaining a refinance loan or a short sale.
- *Abuses in the default and delinquency process.* Servicers sometimes fail to properly send notices of default; prematurely initiate foreclosures during right-to-cure periods and immediately following transfer from another servicer, and they do so without proper notices to borrowers; initiate foreclosure when a borrower is not in default or when borrower has cured the default by paying the required amount; and fail to adhere to loss mitigation requirements of investors.

III. The Role of the Private Marketplace in Regulating Mortgage Servicing Abuses

In today's housing market, when millions of families are in default and at risk of losing their homes, servicers should work to minimize the number of foreclosures by offering modifications for borrowers who have "NPV positive" cases – that is, the expected return to investors from a modified loan is greater than the expected return from a foreclosure. This requires servicers to distinguish between necessary (NPV negative) and unnecessary (NPV positive) foreclosure cases so that servicers can proceed swiftly with the necessary foreclosures and offer sustainable, long-term modifications when foreclosure is unnecessary.

Instead, the servicing system is compounding the problem by proceeding with many unnecessary foreclosures, which harms not only investors and homeowners, but also neighborhoods and communities through spillover effects and other negative externalities. Perverse financial incentives in pooling and servicing contracts illustrate why servicers press forward with foreclosures when other solutions are more advantageous for investors. Servicers are generally paid a fixed percentage of the outstanding balance on a loan for servicing a mortgage when payments are being made on the loan. The traditional mortgage servicing paradigm was marked by a collections mentality, and compensation reflected that mentality. The foreclosure crisis, however, created a need for massive underwriting of loan modifications, and as a result, fees paid for servicing a non-delinquent loan are much too low.[10] According to Amherst Securities, with a typical servicing fee of 25 basis points per year ($625/year on a $250,000 loan), servicers are overpaid for traditional servicing (which costs servicers only about $48 per year) and

[10] Testimony of Laurie Goodman of Amherst Securities Group to the Subcommittee on Housing Transportation, and Community Development of the Senate Committee on Banking, Housing, and Urban Affairs, National Mortgage Servicing Standards and Conflicts of Interest (May 11, 2011), available at http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=484c5b2b-6924-459f-898e-3ae075feeb15.

underpaid for loss mitigation on non-performing loans (which costs about $900/year).[11] On the flip side, servicers may charge and collect a variety of fees after the homeowner goes into default and can recover the full amount of those fees from the foreclosure proceeds, providing strong incentives for proceeding with foreclosure.[12]

Although foreclosing when the case is NPV positive can be in servicers' interests, it is certainly not in the interests of investors. In fact, recent CRL research that used loan level data and simulated NPV outcomes under a variety of scenarios, found that under most conditions, payment-reducing loan modifications would return more value to the investor than a foreclosure, even at high projected modification re-default rates.[13] These beneficial loan modifications are not occurring in large part owing to misaligned incentives for servicers, including that in many cases the servicers own the second mortgages associated with the first mortgages that they are servicing but do not own.

As one investor commented, "It pays for banks to keep mortgages in a state of suspended animation, because they can collect late fees while also protecting second mortgages that are in the bank's portfolio. The misalignment of economic interests between the owners of mortgages and those who service them is the single reason why the mortgage problem has become a crisis and a massive economic drain on this country."[14] Our recent analysis suggests that many more loan modifications should have been made since the foreclosure crisis began, and this failure is to the detriment of both homeowners and investors. Why, then, are investors not able to hold servicers fully accountable for not modifying enough loans?

As Professor Adam Levitin and Tara Twomey highlight in the *Yale Journal on Regulation,*[15] a key principal-agent problem exists between investors and servicers:

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[11] *See* Laurie Goodman, et al, "Alternative Compensation Arrangements for Mortgage Servicing – The Debate Begins," *Amherst Mortgage Insight* (Feb. 2, 2011): "[T]here is widespread awareness that the current system (in which a minimum servicing fee is part of the mortgage rate) was not designed for current market conditions. This minimum servicing fee is far too high for performing loans, and way too low for non-performing loans. To put it into perspective, a 25 bp servicing fee on a $250,000 loan is $625/year or $53/month per loan. One servicer we spoke with estimated his costs of servicing a performing loan at $4/month or $48/year. By contrast, the costs of servicing a nonperforming loan were about $900/year."

[12] For a thorough discussion of the servicing incentive structure, see Testimony of Diane Thompson before the Senate Banking Committee (Nov. 16, 2010), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=df8cb685-c1bf-4eea-941d-cf9d5173873a&Witness_ID=d9df823a-05d7-400f-b45a-104a412e2202; *see also* Diane Thompson, "Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior," (National Consumer Law Center Oct. 2009), available at http://www.nclc.org/images/pdf/foreclosure_mortgage/mortgage_servicing/servicer-report1009.pdf.

[13] *See generally* Wei Li & Sonia Garrison, *Fix or Evict? Loan Modifications Return More Value than Foreclosures* (Mar. 22, 2011), available at http://www.responsiblelending.org/mortgage-lending/research-analysis/fix-or-evict.pdf.

[14] Press Release, "Banks' Foreclosure Bias Hurts Investors" (Mar. 23, 2011) (citing Bill Frey, President of Greenwich Financial Services and a longtime investor advocate), available at http://www.responsiblelending.org/media-center/press-releases/archives/Banks-Foreclosure-Bias-Hurts-Investors.html.

[15] Adam J. Levitin & Tara Twomey, "Mortgage Servicing," *Yale Journal on Regulation* Vol. 28, No. 1 (2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1324023.

> Mortgage investors are unlikely to bargain for adequate servicing because of the information asymmetries and risk allocations involved in securitization. … [Investors] cannot accurately value the quality of loss mitigation provided by a servicer; they lack sufficient information, and even if they had full information, evaluation is difficult because servicing decisions are highly qualitative and contextual. Lacking such information, … [investors] are likely to undervalue the quality of servicing and therefore be unconcerned with the principal-agent cost.[16]

The problem of misaligned incentives is further compounded by a lack of adequate resources, management, and quality control, as identified by the Interagency Review of Foreclosure Policies and Practices earlier this year.[17]

Finally, lack of information and coordination limits the ability of disparate investors to monitor and enforce their interests relative to servicers. Where investors have attempted to assert these rights, as in their present dispute with Bank of America, they have sought servicing benchmarks along the lines that we are discussing today, including thorough review of loss mitigation options and the modification of loans where possible.

If investors have little ability to rein in servicers, borrowers have absolutely no ability to do so. From the borrower's perspective, there is a failure of market choice when it comes to servicing. Homeowners are not allowed to select their servicers, and servicing rights are regularly bought and sold, with borrowers stuck with whomever the investor has selected. Borrowers have no authority to "fire" their servicer for bad service. Because servicers lack a contractual (or duty-bound) relationship with borrowers, and because borrowers are already "locked in" to the relationship, servicers have little incentive to provide adequate customer service.

In short, the current system serves as an impediment to a competitive market. The creation of basic ground rules in servicing that apply to all, and that are enforced as to all, will allow the servicing market to function more effectively, to the benefit of all.

IV. Recommended National Mortgage Servicing Standards

Servicing standards should address two general areas: First, pre-foreclosure loss mitigation, requiring a transparent NPV analysis to determine which foreclosures are avoidable and which are inevitable; and second, a baseline level of required servicer duties, restrictions and requirements to remediate the broad servicing abuses outlined earlier. Our recommendations cover both of these areas.

On the servicing front, the states have again taken the lead in addressing the abuses and shortcomings that are evident. Several states have implemented meaningful servicer regulations over the past several years that are worth reviewing as possible models for federal action. Potential preemption in some areas and other limitations, however, call for strong baseline

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[16] *Id.*

[17] Federal Reserve System, Office of the Comptroller of the Currency, and Office of Thrift Supervision. Interagency Review of Foreclosure Policies and Practices. Washington, D.C. (April 2011), available at http://www.occ.treas.gov/news-issuances/news-releases/2011/nr-occ-2011-47a.pdf.

national standards to ensure that all mortgage loan servicers are covered by the requirements and that such requirements can be effectively enforced.

Perhaps the most comprehensive effort at state regulation – and the most useful model for emulation – comes from the New York State Department of Banking.[18] Effective October 2010, the New York regulator issued far-ranging servicing regulations that include detailed loss mitigation requirements, imposing a general duty "to engage in appropriate loss mitigation options, including loan modifications, to avoid foreclosure," as well as requiring "adequate staffing, written procedures, resources and facilities," requiring that a loan modification be offered where the borrower is at imminent risk of default or in default and the modification would be NPV positive, and including detailed requirements about timing for communications with borrowers, escalation process, and other procedures. Importantly, these regulations seek to end the dual track problem by providing that servicers avoid initiating foreclosure action if the borrower is being considered for a loan modification, or is in a trial or permanent modification.

In addition to addressing loss mitigation, the New York regulations tackle the following servicer issues, among others: (1) impose and define a servicer duty of good faith and fair dealing to the borrower; (2) require accurate payment from and accounting of escrow accounts; (3) specify proper crediting of payments; (4) mandate annual statement of accounts and, when requested, payment histories; (5) require clear, understandable and accurate payoff balances within five business days of a request; (6) provide limitations and transparency around fees; (7) authorize the Superintendent of Banks to require quarterly reporting on mortgage loans and loss mitigation efforts; and (8) include prohibitions on improper force-placed insurance.

North Carolina was an early adopter of mortgage servicing standards.[19] These standards are less detailed than those in New York, including, for example, a generalized loss mitigation standard, which requires:

> In the event of a delinquency or other act of default on the part of the borrower, the mortgage servicer shall act in good faith to inform the borrower of the facts concerning the loan and the nature and extent of the delinquency or default and, if the borrower replies, to negotiate with the borrower, subject to the mortgage servicer's duties and obligations under the mortgage servicing contract, if any, to attempt a resolution or workout to the delinquency.[20]

This law also requires servicers to report to the Commissioner of Banks on its mortgage loans and loss mitigation activities.

The North Carolina law also puts in place other general duties, requiring that a mortgage servicer do the following: (1) safeguard and account for any money handled for the borrower; (2) follow

[18] New York Banking Department Law, Regulations & Interpretations. Part 419. Servicing Mortgage Loans: Business Conduct Rules, available at http://www.banking.state.ny.us/legal/ar419tx.htm.
[19] N.C. Gen. Stats. 53-244.110 (2009), available at http://law.justia.com/codes/north-carolina/2009/Chapter_53/GS_53-244_110.html.
[20] *Id.* at 53-244.110(7).

reasonable and lawful instructions from the borrower; (3) act with reasonable skill, care, and diligence; and (4) file periodically with the Commissioner a complete, current schedule of the ranges of costs and fees it charges borrowers for its servicing-related activities.[21]

In May of this year, Montana passed legislation that is substantially similar to North Carolina's legislation to regulate mortgage servicers.[22]

Federal policymakers should move forward with similar servicing standards, based on the progress made in the states. The Federal standards should at a minimum include the following:

1) Mandatory Loss Mitigation Before the Start of the Foreclosure Process

Mandatory loss mitigation before foreclosure is in the interest of both investors[23] and homeowners. Prior to a servicer initiating foreclosure, every loan should receive a good-faith review of foreclosure alternatives by using an NPV analysis to determine whether re-amortization, interest rate reduction, term extension and/or principal reduction of the loan will reduce payments to a sustainable level.

An NPV analysis such as the one required by servicers participating in HAMP assesses whether the investor receives more revenue from a loan modification or a foreclosure. This calculation compares the cash flow anticipated from future mortgage payments to the cash flow anticipated from foreclosing on the property, based on inputs that include the homeowner's income, credit score, current payment status, debt-to-income ratio, and property value, plus factors relating to the property's future value and likely resale price.

- *Modifications Offered for NPV Positive Loans.* When a sustainable loan modification is a better financial deal for the investor than a foreclosure, the servicer should be required to offer the borrower the loan modification, including request of a waiver in the case of investor or pooling and servicing agreement (PSA) restrictions.

- *"Soft Landing" Alternatives in the Case of NPV Negative Loans.* If a sustainable loan modification is not NPV positive, the servicer should be required to consider a short sale or deed-in-lieu-of-foreclosure if the borrower chooses to pursue these options.

- *Unemployment Forbearance Options.* Servicers should proactively engage with homeowners at risk of foreclosure owing to loss of income attributable to unemployment or underemployment to determine whether an unemployment forbearance program may allow homeowners to avoid foreclosure while they actively seek employment.

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[21] *Id.* at 53-244-110(1)-(4).

[22] *See* Montana HB 90 (McNutt) (signed by Governor May 5, 2011), available at http://data.opi.mt.gov/bills/2011/billhtml/HB0090.htm.

[23] *See* Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), *Factors Affecting Implementation of the Home Affordable Modification Program* at 8 (Mar. 25, 2010), available at http://www.sigtarp.gov/reports/audit/2010/Factors_Affecting_Implementation_of_the_Home_Affordable_Modification_Program.pdf ("According to Treasury, the NPV model increases investors' confidence that the modifications under HAMP are in their best financial interests and helps ensure that borrowers are treated consistently under the program by providing a transparent and externally derived objective standard for all loan servicers to follow.").

- *Borrowers Should Retain their Legal Rights Upon Entering into a Modification.* Today, many modifications are neither affordable nor permanent, highlighting the need for borrower legal rights.

2) Transparency in the Net Present Value Determination

In May of this year, Treasury launched www.checkmyNPV.com, a free public online NPV calculator to assist homeowners in understanding the NPV evaluation process under HAMP and in conducting an NPV evaluation of their mortgages.[24]

Mortgage servicers should be required to make the NPV analysis for proprietary loan modifications equally accessible to homeowners. As a result, any errors or discrepancies in the inputs and assumptions used by the servicer could be addressed and resolved promptly. As noted by the Association of Mortgage Investors, because only servicers have access to the loan file, transparency is vital both in allowing borrowers to verify the information and ensuring investors have access.[25]

In addition, borrowers whose denial is based on investor restrictions notwithstanding a determination that their loan is NPV positive should receive basic information, including the investor or guarantor's name, identification of the controlling document, and a summary of efforts taken to secure investor approval so that borrowers are in a position to escalate their matter to the investors rather than exclusively relying on communication with their servicer.

3) Elimination of Dual Track

Dual track first gained notoriety in association with HAMP, when servicers moved forward with widespread foreclosure sales before determining borrowers' eligibility for HAMP. This was an important factor in loss of confidence in the program. In response to criticism, the Department of the Treasury issued Supplemental Directive 10-02, which requires servicers to provide borrowers not yet in the foreclosure process with a HAMP review and answer before the servicer could "refer any loan to foreclosure."[26] Notwithstanding this language, some servicers have claimed that, in non-judicial foreclosure states, they can begin the foreclosure process by filing a notice of default. For those borrowers who submit a HAMP request after a loan has entered the foreclosure process, HAMP requires that the servicer make all efforts to halt foreclosure activity

[24] This was made available pursuant to Section 1482 of the Dodd Frank Wall Street Reform and Consumer Protection Act (2010).
[25] Association of Mortgage Investors (AMI), *The Future of the Housing Market after the Crisis: Remedies to Restore and Stabilize America's Mortgage and Housing Markets*, White Paper (January 2011), available at http://the-ami.com/wp-content/uploads/2011/01/AMI_State_AG_Investigation_Remedy_Recommendations_Jan_2011.pdf.
[26] U.S. Treasury Dept., Making Home Affordable, *Home Affordable Modification Program – Borrower Outreach and Communication*, Supplemental Directive 10-02 (March 24, 2010), available at https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/sd1002.pdf. These guidelines are now found in Section 3 of Chapter II of the Making Home Affordable Program Handbook for Servicers of Non-GSE Mortgages: Version 3.2 (June 1, 2011), available at https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/mhahandbook_32.pdf.

once a borrower accepts a trial period plan.[27] If a sale date has already been scheduled, the borrower must submit a request for HAMP consideration so that it is received at least seven days before the sale date in order to require the servicer to suspend the foreclosure sale.[28]

Despite this Treasury directive, issues with dual track have persisted within HAMP, whether because of lack of compliance or the limitations of the standards themselves. In May 2011, the California Reinvestment Coalition surveyed 55 California housing counselors who serve thousands of borrowers every month, and found that a full 94 percent of counselors reported having worked with clients who lost their homes while under review for a loan modification.[29]

On June 30, the OCC issued supervisory guidance related to bank foreclosure practices that purported to address the dual track problem.[30] Unfortunately, this guidance took a step back from the HAMP requirements, directing bank management to "suspend foreclosure proceedings for successfully performing trial period modifications where they have the legal ability to do so under servicing contracts." The two tracks of "dual track" are, first, the loan modification application and approval process, and second, the foreclosure process. Ending dual track would require halting the foreclosure process when a borrower is *applying* for a loan modification in good faith. The OCC guidance inadvertently provides incentives for delays and loan modification denials by providing that a foreclosure need not be suspended unless and until there is a "successfully performing trial period modification."

While these developments acknowledge the tremendous challenges presented by dual track, potential ambiguities and conflicts among the different rules call for a clear, strong standard that prohibits any initiation of or movement in the foreclosure process, whether in a judicial or non-judicial state, when a borrower is applying for a loan modification. Without a clear, consistent and strong standard, loss mitigation efforts will continue to be significantly undermined by this practice, which prioritizes expediency over accuracy and, in many cases, homeowners' ability to retain their homes.

4) Single Point of Contact or Case Manager Model

The drastic increase in the number of delinquent borrowers has required servicers to scramble to hire and train new staff. Not surprisingly, industry observers have noted that this strain on servicing capacity has coincided not just with problems related to the foreclosure process, but

[27] *Id.*
[28] *Id.*
[29] *See* Paul Kiel, "Bank Errors Continue to Cause Wrongful Foreclosures" *ProPublica* (June 24, 2011) (referring to the forthcoming report, California Reinvestment Coalition, *Race to the Bottom: An Analysis of HAMP Loan Modification Outcomes by Race and Ethnicity for California*), available at http://www.propublica.org/article/bank-errors-continue-to-cause-wrongful-foreclosures. The survey from the California Reinvestment Coalition (CRC) will be its seventh, and the problem appears to be getting worse. In its last survey, CRC found that over 60% of counselors responded that they had clients who lost their home while negotiating with their servicer. *See* California Reinvestment Coalition, *Chasm Between Words and Deeds VI: HAMP Is Not Working* at 3 (July 2010), available at http://calreinvest.org/publications/crc-reports. Only 20% of counselors had not seen clients either lose their home or have a sale date scheduled while negotiating. *Id.*
[30] Office of the Comptroller of the Currency, Foreclosure Management Supervisory Guidance, OCC 2011-29 (June 30, 2011), available at http://www.occ.gov/news-issuances/bulletins/2011/bulletin-2011-29.html

also with a surge in borrower complaints related to the loss mitigation process and servicer communications.

A recent survey of foreclosure-intervention counselors found a multitude of servicer obstacles to successful loan modifications, including lack of qualified personnel and communication inefficiencies that confuse and even drive borrowers away.[31] These inefficiencies include lost paperwork, inadequate follow-up during the evaluation process, and the borrower being directed to numerous different representatives who often have different information for the borrower or are incapable of offering appropriate assistance.

For borrowers attempting to navigate the loss mitigation process, lack of access to personnel who are knowledgeable about their matter and who can provide reliable information continues to be a tremendous impediment. Requiring that servicers identify a case manager who has the authority to resolve issues and serve as the borrower's single point of contact would ensure both access and accountability as borrowers work to provide servicers with the information necessary for a meaningful evaluation of foreclosure alternatives.

5) Third Party Review of Denials of Loan Modifications

Given the high frequency of errors that have occurred in the processing of requests for loan modifications and the critical importance of these decisions, borrowers should have the right of independent third party review of denials loan modifications. This both protects the interests of individual borrowers and investors, it provides monitoring of the overall servicing process and can detect systemic problems that develop.

6) Changes in Servicer Compensation

As discussed previously in this testimony, servicers' compensation is not aligned with the work that they need to do; they are currently overpaid for performing loans and underpaid for those in default. Because loss mitigation work is complicated, case-specific, and time-intensive, servicer compensation for troubled loans should be more aligned with how specialty servicers are paid.

7) Standards to Address More General Servicing Abuses

In addition to addressing problems in the loss mitigation and foreclosure processes, servicing standards should address the other abuses outlined earlier in this testimony, federal banking regulators, the Consumer Financial Protection Bureau (CFPB), and the states should work in partnership to vigorously enforce these servicing standards. Indeed, the existence of these widespread servicing abuses and failings that have gone unchecked for so many years (together with the borrower's inability to use the market to do anything about them) highlights the necessity of the CFPB.

Solutions to these other more general abuses include requiring the proper application of borrower payments; requiring servicers to verify lack of insurance before force-placing it and ensuring that

[31] David A. Smith, Louise Perwien, & Janneke Ratcliffe, UNC Center for Community Capital, *Mortgage Servicers Response to Borrowers in Crisis: A Report from the Front Lines*, (2009).

the cost of such insurance is reasonable and proportional to the cost of providing it; providing for real penalties for mismanaging escrow accounts; and requiring servicers to provide payoff quotations to borrowers to facilitate refinancings and short sales.

V. Conclusion

In summary, deep-seeded problems in the servicing industry are harming borrowers, investors, and the economy as a whole. Putting in place fair, basic ground rules for mortgage servicing is critical to addressing the housing crisis that continues to plague our economy. Today, servicers too often engage in a wide range of abuses related to the foreclosure/loss mitigation process and more broadly. These include failure to properly engage in loss mitigation, which results in foreclosure on NPV positive borrowers who could actually afford to pay more in a loan workout than the revenues an investor would yield from foreclosures. If servicers routinely engaged in proper loss mitigation prior to foreclosure, more distressed homeowners would be able to stay in their homes, paying more through sustainable modifications than investors would receive through foreclosure.

Federal policymakers should put in place and robustly enforce strong baseline servicing standards, the most important of which is to require loss mitigation, with third-party review prior to the start of the foreclosure process, thus eliminating dual track. In addition, to ensure accountability, servicers should be required to be transparent in the NPV calculation, even for portfolio loans. Borrowers in default should have a single point of contact who can provide reliable information and ensure that paperwork necessary for loss mitigation is properly processed. Servicers should also be prohibited from engaging in other abusive practices, such as failure to pay escrowed taxes and insurance, misapplying payments, and force-placing insurance when it is not warranted (while charging exorbitant rates nowhere near the actual cost of the insurance), among others.

Equally important to imposing strong servicing standards is ensuring that those standards are vigorously enforced. Federal banking regulators, the CFPB, and the states should robustly enforce the standards to ensure that servicers have every incentive to comply with them.

Indeed, the current failure of many servicers to engage in loss mitigation underscores the importance of maintaining a strong and independent CFPB. The Dodd-Frank Act transferred key responsibilities related to mortgage servicing to CFPB, including, effective July 21, 2011, rulemaking, supervision, and enforcement authority under the Real Estate Settlement Procedure Act (RESPA). RESPA includes a range of servicing provisions, most recently amended through Dodd-Frank, to strengthen protections around escrows, force-placed insurance, and responses by servicers to qualified written requests from borrowers. Dodd-Frank also gives CFPB the authority to address unfair, deceptive, and abusive practices in the mortgage market. And CFPB's statutory role in mortgage servicing began even prior to July 21: Section 1025(e) of Dodd-Frank gives CFPB immediate authority to coordinate with the prudential regulators in supervision of large banks, which includes their servicing activities.

Given CFPB's immediate and ongoing responsibilities with respect to mortgage servicing, its engagement in the ongoing settlement negotiations between the Attorneys General and mortgage servicers is only appropriate; in fact, the CFPB's failure to be engaged would constitute a breach of its statutory duties.

I look forward to answering any questions you may have for me. Thank you for the opportunity to testify.

Testimony of Raj Date

Associate Director for Research, Markets, and Regulation

Consumer Financial Protection Bureau

Before the Subcommittee on Financial Institutions and Consumer Credit

and the Subcommittee on Oversight and Investigations

Committee on Financial Services

United States House of Representatives

Thursday, July 7, 2011

Chairman Capito and Chairman Neugebauer, Ranking Member Maloney and Ranking MemberCapuano, and members of the Subcommittees, thank you for inviting me to testify about mortgage servicing standards. My name is Raj Date and I serve as Associate Director for Research, Markets, and Regulations for the Consumer Financial Protection Bureau ("CFPB" or "Bureau").

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") established the CFPB as an independent bureau within the Federal Reserve System and charged it with ensuring that consumers have the information they need to make financial decisions that are best for themselves and their families. The Bureau will work to promote fairness, transparency, and competition in the markets for mortgages, credit cards, and other consumer financial products and services. The CFPB will set – and enforce – clear, consistent rules that will allow banks and other firms to compete on a level playing field and that will allow consumers to see clearly the costs and risks of financial products.

The Bureau is not yet open for business. But two weeks from now, on July 21st, the Bureau will receive transferred authority from existing regulators to administer federal consumer financial protection laws. And on that day, mortgage servicing will be one of the CFPB's priorities.

Mortgage servicing is important. It is an enormous market, with some $10.4 trillion of principal balances outstanding.[1] It is a market that has been marked by pervasive and profound consumer protection problems, as documented in recent reports by a number of other government agencies.[2] And, importantly, mortgage servicing is a market that is marked by two structural features that make it especially prone to the risk of consumer harm.

The first of those structural features is simple: in the vast majority of cases, consumers do not choose their mortgage servicers. Mortgage servicing rights can be, and quite frequently are, bought and sold among servicers irrespective of the borrowers' consent. There are certainly legitimate and desirable aspects to the liquidity of mortgage servicing rights, but it has a practical disadvantage as well. Let me illustrate with an example. Last week, I had a prescription filled. If my pharmacist had made me stand in a long line, or if she was rude to me, or if she repeatedly lost my prescription paperwork, or if she was impossible to find on the phone, or if she gave me guidance that conflicted with my doctor's, or if she tried to give me the wrong medicine, then next time, I would simply go to a different pharmacist. That's how most consumer-facing markets work. But I get to choose my pharmacist. I don't typically get to choose my mortgage servicer.

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[1] Federal Reserve Statistical Release Z.1, *Flow of Funds Accounts of the United States, First Quarter 2011*, at 96 (June 9, 2011), http://www.federalreserve.gov/releases/z1/Current/z1.pdf.

[2] See *infra* notes 8-23 and accompanying text.

The second structural feature of mortgage servicing that relates to consumer protection is this: the current structure of servicing fees creates a strong incentive to underinvest in adequate technology, people, and processes to handle cyclical spikes in delinquencies.[3] There are two important things to know about these servicing fees. First, the fees are fixed and typically do not go up if loans become delinquent and need more work. Second, these fees are not remotely high enough to properly service high volumes of delinquent loans.[4] The typical fixed servicing fee is 25 basis points (bps) a year for prime fixed-rate loans, 37.5 bps a year for prime adjustable-rate mortgages, and 50 bps a year for subprime loans.[5] For a typical $175,000 loan, that works out to around $440 a year for a prime fixed-rate loan, $660 a year for a prime ARM, and $880 a year for a subprime loan.

At the same time, servicing a seriously delinquent loan can cost well over $1,000 a year.[6] This makes sense, because servicing a delinquent loan requires significantly greater work and expertise. Servicing performing loans is cheap and profitable: it consists of processing loan payments, which is typically highly automated. Servicing delinquent loans, in contrast, takes one-on-one contact with borrowers, costly collection efforts, and specialized staff to re-underwrite loans in order to compare the cost-effectiveness of workouts versus foreclosures. In the private-label market, servicers evaluate cost-effectiveness according to net present value tests

[3] See, e.g., Testimony of Laurie Goodman, Amherst Securities Group, before the Subcommittee on Housing, Transportation, and Community Development of the Senate Committee on Banking, Housing, and Urban Affairs, at 1 (May 12, 2011), http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=484c5b2b-6924-459f-898e-3ae075feeb15.

[4] See *id.* at 1.

[5] See, e.g., Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang and Eileen Mauskopf, "The Incentives of Mortgage Servicers: Myths and Realities," Finance and Economics Discussion Series, Divisions of Research & Statistics and Monetary Affairs, Federal Reserve Board, Working Paper 2008-46, at p. 15 (2008).

[6] See, e.g., Federal Housing Finance Agency, Servicing Compensation Initiative Pursuant to FHFA Directive in Coordination with HUD, p. 7 (Feb. 2011) (cost of over $1,000 annually for a continuously delinquent loan), http://www.fhfa.gov/webfiles/19719/FHFA_Servicing_Initiative_-_Background_and_Issues_2011-02-14_3pm_FINAL.pdf.

contained in their pooling and servicing agreements with securitized trusts. Nevertheless, private investors are generally too dispersed and lack sufficient information updates from servicers to monitor servicers' performance adequately.

In response to this state of affairs in the mortgage servicing area, the Federal Housing Finance Agency ("FHFA"), in a joint initiative with the U.S. Department of Housing and Urban Development ("HUD"), recently voiced concerns that the flat-fee structure undermines the "optimal servicing of non-performing loans" and was "not designed for current market conditions."[7] Put another way, under the prevailing market standards for servicer compensation, taking on the servicing of a loan is something of a bet on credit. If a loan remains performing, then servicing the loan remains a quite profitable affair. But if the borrower becomes delinquent, then the cost of servicing the loan is likely to be many times greater than the revenue from servicing that loan. If a servicer's portfolio contains many more nonperforming loans than the servicer expected, the servicer stands to lose money.

Unfortunately, when it became clear that servicers had taken on riskier than expected portfolios, they did not simply internalize the higher costs of servicing in an adverse credit environment. Instead, many servicers, when faced with an upswing in mortgage delinquencies, cut corners, often loosening operational protocols and putting inadequate resources into dealing with troubled homeowners.

According to other Federal agencies, the evidence of shoddy practices and underinvestment is striking. In examinations of fourteen major servicers this spring, the Comptroller of the Currency, the Federal Reserve System, and the Office of Thrift Supervision concluded that servicers were "emphasiz[ing] speed and cost efficiency over quality and

[7] Federal Housing Finance Agency, "FHFA Announces Joint Initiative to Consider Alternatives for a New Mortgage Servicing Compensation Structure," News Release (Jan. 18, 2011), http://www.fhfa.gov/webfiles/19716/Servicing_model11811.pdf.

accuracy" in their foreclosure processes.[8] According to these prudential banking regulators, the servicers had "inadequate organization and staffing of foreclosure units to address the increased volumes of foreclosures."[9] Furthermore, a "large percentage" of the servicers' staff "lacked sufficient training in their positions."[10] To give some sense of the degree of this underinvestment, the Government Accountability Office reported that "one servicer that had previously understaffed" its foreclosure functions "increased its document-signing staff from 5 to 80"after the probe of the foreclosure process.[11]

The prudential regulators' examinations uncovered legal violations as well. The regulators found that servicers and their contractors had filed false affidavits in court under oath and disregarded state requirements for notarizations, resulting in "violations of state foreclosure laws designed to protect consumers."[12] These violations, together with other problems the examinations identified, were so severe that they had "an adverse effect on the functioning of the mortgage markets" and posed "significant risk to the safety and soundness of mortgage

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[8] Federal Reserve System, Office of the Comptroller of the Currency, and Office of Thrift Supervision, "Interagency Review of Foreclosure Policies and Practices," at 7 (April 2011), http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47a.pdf.

In addition, last month the Treasury Department rated the performance of the largest servicers participating in the *Making Home Affordable* program, ranking them on identifying and contacting homeowners; homeowner evaluation and assistance; and program management, reporting, and governance. Treasury determined that six of the servicers needed moderate improvement and four needed substantial improvement in the first quarter of 2011. None of the servicers needed only minor improvement. Department of the Treasury, Making Home Affordable: Program Performance Report Through April 2011, at 16 (June 2011), http://www.treasury.gov/initiatives/financial-stability/results/MHA-Reports/Documents/April%202011%20MHA%20Report%20FINAL.PDF.

[9] Federal Reserve System et al., *supra* note 8, at 3.

[10] *Id.* at 7.

[11] Government Accountability Office, "Mortgage Foreclosures: Documentation Problems Reveal Need for Ongoing Regulatory Oversight," at 26 (GAO-11-433, May 2011).

[12] Federal Reserve System et al., *supra* note 8, at 3-4, 5, 8; Government Accountability Office, *supra* note 11, at 26.

activities."[13] These findings were the basis for formal enforcement actions by the agencies, resulting in consent orders against all fourteen servicers.

Poor servicing practices have inflicted hardship on borrowers, investors, and the country as a whole. As has been widely reported, servicers frequently did not answer distressed borrowers' calls or letters in a timely fashion, and often simply lost their paperwork.[14] Servicers sometimes charged homeowners inaccurate fees that could make "it more difficult for [the] borrowers to bring their loans current."[15] In extreme cases, borrowers suffered wrongful foreclosures and lost their homes. Among those affected were servicemembers on active duty who were foreclosed upon in violation of the Servicemembers Civil Relief Act.[16] Similarly, there were cases where servicers had approved borrowers for loan modifications, but subsequently foreclosed on those same borrowers; the prudential regulators' report also acknowledged that borrowers could have their loss mitigation options curtailed as a result of the servicers' "dual-track" processes.[17] In testimony this May, Federal Deposit Insurance Corporation Chairman Sheila Bair, commenting on the examinations' scope, stated that "we do

[13] Federal Reserve System et al., *supra* note 8, at 4-5, 7.

[14] See, e.g., Cordell et al., *supra* note 5.

[15] Federal Reserve System et al., *supra* note 8, at 5. See also Government Accountability Office, *supra* note 11, at 41 (weaknesses in servicers' foreclosure processes "could result in inaccurate fees and charges assessed against a borrower"); Goodman Testimony, *supra* note 3, at 6-7 (to compensate for their low servicing fees on delinquent loans, servicers "often mark up fees [for foreclosure and related services] considerably," "making it harder for a borrower to become current").

[16] Federal Reserve System et al., *supra* note 8, at 3; Government Accountability Office, *supra* note 11, at 28.

[17] Federal Reserve System et al., *supra* note 8, at 3, 5; Government Accountability Office, *supra* note 11, at 41 ("borrowers could find their loss mitigation options curtailed because of dual-track processes that result in foreclosure even when a borrower has been approved for a loan modification").

not yet really know the full extent of the problem" and that "the horizontal review only looked at processing issues."[18]

Investors too were injured by servicing failures. Excessive fees charged to borrowers by servicers for services related to defaults increased loan losses to investors.[19] Similarly, servicers' failure to invest in adequate loss mitigation operations resulted in costly foreclosures in situations where loan modifications would have resulted in greater recovery to investors.[20] Investors have also raised concerns about irregularities in the documentation of their ownership interests.[21]

Adding to this harm is the damage to the nationwide housing market. The prudential regulators specifically found that the weaknesses in foreclosure processes "slow[ed] the clearing of excess inventory of foreclosed properties and [led] to extended periods of depressed home prices."[22] Widely publicized weaknesses in foreclosure processes have also hurt home buyer confidence,[23] likely further impairing the housing markets.

In the Dodd-Frank Act, Congress took important steps that will correct flaws in the federal regulation of mortgage servicing. As the Government Accountability Office has found, to date, federal oversight of mortgage servicers' activities has been "limited and fragmented."[24]

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[18] Statement, Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation, on Oversight of Dodd-Frank Implementation: Monitoring Systemic Risk and Promoting Financial Stability, before the Senate Committee on Banking, Housing, and Urban Affairs, at 22 (May 12, 2011), http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=94d50f1a-75eb-4586-b025-76e44870816b; Government Accountability Office, *supra* note 11, at 28.

[19] See, e.g., Goodman Testimony, *supra* note 3, at 6.

[20] Goodman Testimony, *supra* note 3, at 2-4.

[21] See, e.g., Bair Statement, *supra* note 18, at 22-23; Dan Fitzpatrick, *BofA Nears Huge Settlement*, Wall Street Journal, June 29, 2011.

[22] Federal Reserve System et al., *supra* note 8, at 6; Government Accountability Office, *supra* note 11, at 42.

[23] Federal Reserve System et al., *supra* note 8, at 6.

[24] Government Accountability Office, *supra* note 11, at 14.

The two key consequences of this flawed regulatory structure have been the lack of comprehensive federal standards for mortgage servicers, and the lack of any direct federal oversight of non-depository servicers.

In creating the CFPB, Congress vested the agency with sufficient jurisdiction and powers to protect consumers in all mortgage servicing activity – regardless of the servicer's charter or locale. While the CFPB can address consumer protection, a comprehensive approach that also protects investors, the financial sector, and the housing market requires the coordinated action of many federal regulators, including the FHFA and the prudential regulators. The Bureau will be working together with these and other agencies to the maximum extent possible.

In overseeing mortgage servicing, the CFPB has a variety of tools – including supervision and supervisory guidance, enforcement, and rulemaking – at its disposal. The Dodd-Frank Act authorizes the CFPB to promulgate consumer protection standards for the entire mortgage servicing industry, and to ensure compliance with those standards by large depository institutions, their affiliates, and nonbank servicers. The Bureau will receive rulemaking authorities under various federal laws relevant to mortgage servicing, consisting both of authorities that will transfer to the Bureau from other agencies, including the Federal Reserve Board, HUD, and the Federal Trade Commission, and new rulemaking authorities granted by the Dodd-Frank Act. But new regulations take many months to promulgate, and homeowners are facing problems here and now. In this regard, it is important to note that the Dodd-Frank Act leveled the playing field by placing independent nonbank mortgage servicers under CFPB supervision. The CFPB will use its authorities to help ensure that all mortgage servicers have adequate systems and procedures to ensure compliance with federal law.

In using these authorities, the Bureau will work together with the prudential regulators and other agencies to ensure the efficient and effective exercise of its responsibilities and to improve the functioning of the mortgage servicing market. The Secretary of the Treasury and federal regulators have issued a call for national servicing standards.[25] To that end, the federal prudential regulators, together with HUD, the Treasury Department, and the FHFA, have formed an interagency working group to collaborate on national mortgage servicing standards. Earlier this year, these agencies invited the CFPB to join the working group, and we have participated in the group ever since.[26] Although the CFPB does not yet have rulemaking or supervisory authority over mortgage servicing, our staff is working hard to prepare to assume these responsibilities when the agency becomes fully operational. We look forward to continuing the interagency discussion and coordination to make sure the rules of the road for servicing are fair and clear for consumers, servicers, and the broader market.

Chairmen Capito and Neugebauer, Ranking Members Maloney and Capuano, thank you for the opportunity to testify.

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[25] See Government Accountability Office, *supra* note 11, at 32-34; Written Testimony of Secretary Timothy F. Geithner Before the House Committee on Financial Services, March 1, 2011; Testimony of John Walsh, Acting Comptroller of the Currency, before the Committee on Banking, Housing, and Urban Affairs, United States Senate, February 17, 2011; Statement by Daniel K. Tarullo, Member, Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing and Urban Affairs, United States Senate, December 1, 2010; Speech by Sheila Bair, Chairman of the Federal Deposit Insurance Corporation, at the Mortgage Bankers Association's Summit on Residential Mortgage Servicing for the 21st Century, January 19, 2011.

[26] See Government Accountability Office, *supra* note 11, at 34.

EMBARGOED UNTIL DELIVERY

STATEMENT OF

MARK PEARCE
DIRECTOR
DIVISION OF DEPOSITOR AND CONSUMER PROTECTION
FEDERAL DEPOSIT INSURANCE CORPORATION

on

MORTGAGE SERVICING: AN EXAMINATION OF THE ROLE OF FEDERAL REGULATORS IN SETTLEMENT NEGOTIATIONS AND THE FUTURE OF MORTGAGE SERVICING STANDARDS

before the

SUBCOMMITTEES ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT, AND OVERSIGHT AND INVESTIGATIONS
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

July 7, 2011
Washington, DC

Chairman Capito, Chairman Neugebauer, Ranking Members Maloney and Capuano, and members of the Subcommittees, thank you for the opportunity to testify on behalf of the Federal Deposit Insurance Corporation about the ongoing need to address and resolve challenges in mortgage servicing. The issues involved continue to impact our housing market, borrowers, and communities across the nation.

As you know, the FDIC is not the primary federal regulator for the largest financial institutions and loan servicers where major mortgage servicing and foreclosure deficiencies have been found. Nevertheless, we remain concerned about the potential ramifications of the deficiencies among the largest institutions, most of which we insure.

In April of this year, the primary federal regulators took an important first step in addressing servicer deficiencies by issuing enforcement orders related to foreclosure practices against 14 of the largest mortgage servicers. If implemented effectively, these orders will put servicers on a path to having the staffing, management, and operational controls necessary to work effectively with homeowners to fairly and efficiently resolve mortgage defaults.

However, the interagency review of foreclosure practices did not purport to examine loan modification practices or other potential errors in loan servicing. That is why the orders require a robust look-back review of prior foreclosures, and why the FDIC supports the state-federal collaboration between the State Attorneys General and the Department of Justice and several other federal agencies.

A comprehensive resolution for past servicing errors is essential to the recovery of the housing market and greater economy. Past servicer errors have given rise to a multitude of actual and potential claims in litigation, placing a cloud over recent foreclosures and transfers of title. Market anxiety regarding the validity of prior actions dampens expectations regarding the housing market's recovery and discourages the return of private capital to the mortgage market. Furthermore, until servicers improve their practices and processes, some current homeowners will miss opportunities to avoid foreclosure, while others will remain able to game the system to delay the inevitable. Given the continuing fragility of the housing market, effective servicing is more important than ever.

In my testimony, I will begin with an overview of the FDIC's work and participation in addressing deficiencies and challenges in mortgage servicing and foreclosure practices. Second, I will discuss the impact of the continuing mortgage operation problems. Finally, I will highlight some key best practices and recommendations to address mortgage servicing.

The FDIC's Role in Addressing Mortgage Servicing

Poor mortgage servicing practices have both contributed to the creation of the housing crisis and acted as an impediment to its resolution. Resolution, however, will be challenging since the roots of today's mortgage servicing problems began before the financial crisis. For example, the traditional structure of third-party mortgage servicing fees created perverse incentives to automate critical servicing activities and cut costs at the expense of the accuracy and reliability of loan documents and information. When delinquencies began to rise, large servicers were ill-prepared to assist the millions of homeowners falling behind on their mortgages.

As early as 2007, the FDIC called for mortgage servicers to build programs and resources to restructure troubled mortgages on a broad scale. In 2008, the FDIC, as conservator for the failure of IndyMac, FSB, implemented a broad-based loan modification program.[1] The lessons learned from this initial effort led us to propose a standardized loan modification program in 2009 for all loss-share partners.

In July 2010, the FDIC issued a securitization of $470 million of performing single-family mortgages. This transaction was the first single-family securitization in the history of the FDIC and the first time the FDIC sold assets in a securitization in the current financial crisis. The transaction included the alignment of the servicer's compensation with performance, independent third party oversight, and the ability to adapt servicing standards to changes in the performance of the underlying collateral and market conditions.

In the wake of news last fall of "robo-signing" at some of the largest mortgage servicers, the FDIC was invited by the primary regulators of 14 of the nation's largest servicers to participate in simultaneous or "horizontal" reviews of foreclosure practices. The findings of the interagency review clearly show that the largest mortgage servicers had significant deficiencies in numerous aspects of their foreclosure processing. These deficiencies included the filing of inaccurate affidavits and other documentation in

[1] http://www.fdic.gov/consumers/loans/loanmod/loanmodguide.html

foreclosure proceedings, inadequate oversight of attorneys and other third parties involved in the foreclosure process, inadequate staffing and training of employees, and the failure to effectively coordinate the loan modification and foreclosure process to ensure effective communications to borrowers seeking to avoid foreclosures.

As a result, the primary federal regulators issued enforcement orders to all 14 of the reviewed institutions to improve foreclosure and servicing practices. The enforcement actions put these large servicers on a path to improving their management of the foreclosure and servicing processes, including the creation of a single point of contact for homeowners seeking assistance.

However, these consent orders do not fully identify and remedy past errors in mortgage-servicing operations of large institutions; in fact, the scope of the interagency review did not include a review of loan modification efforts of these servicers or the fees charged in the servicing process.[2] Much work remains to identify and correct past errors and to ensure that the servicing process functions effectively, efficiently, and fairly going forward.

As a consequence of the limited scope of the reviews, the consent orders require these servicers to retain independent, third party consultants to review past foreclosure actions and report the results of those reviews back to the regulators. It is essential that

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[2] As reported in the *Interagency Review of Foreclosure Policies and Practices;* (http://www.federalreserve.gov/BoardDocs/RptCongress/interagency_review_foreclosures_20110413.pdf at 2 (last visited July 5, 2011)), "Examiners may not have uncovered cases of misapplied payments or unreasonable fees, inappropriate force-placing of insurance, failure to consider adequately a borrower for a modification, or requiring a borrower to be delinquent to qualify for a loan modification."

these reviews be credible. Therefore, these reviews must be independent and comprehensive in order to identify errors and to provide meaningful remedies to borrowers harmed in the process. In particular, it is critical for the period covered by the consent orders that the consultants review all foreclosures where the homeowner had applied for a loan modification, filed a complaint against the servicer, or was a member of the military.[3] In addition, given the importance of these reviews, an interagency team must conduct quality control samples of the consultants to ensure that the consultants are identifying issues consistently.

Finally, in addition to the work of the federal banking regulators, the FDIC continues to support the separate federal and state collaboration between the State Attorneys General and federal regulators led by the U.S. Department of Justice. The enforcement orders issued by the federal banking regulators complement, rather than preempt or impede, this ongoing collaboration.

Impact of Failure to Resolve Claims and Improve Servicing Operations

As mentioned earlier in my testimony, these servicing problems continue to present significant operational and litigation risk to servicers and originating banks. Servicers continue to encounter challenges to their legal standing to foreclose on individual mortgages as borrowers in approximately 90,000 foreclosure actions have taken steps to forestall foreclosure.

[3] http://www.justice.gov/opa/pr/2011/May/11-crt-683.html

To put this in context, we are tracking the following foreclosure and mortgage-related cases: (1) borrower class actions – 67 pending class-action suits in 23 states challenging foreclosures based upon robo-signing, defective assignments, reliance upon the Mortgage Electronic Registration Systems (MERS), or the misapplication of payments; (2) class action cases related to the Home Affordable Modification Program (HAMP) – 57 class actions in 25 states alleging impropriety in processing loan modifications regarding HAMP, as well as another 24 class actions in 18 states alleging misconduct under non-HAMP modification programs; (3) investor actions – 21 investor suits in 12 states alleging foreclosure and securitization misconduct that seek to "put back" defaulted loans to the loan originator and damages based upon failure to properly form the securitization trusts, misrepresentation regarding underwriting and other misrepresentations, robo-signing, or the use of MERS; and (4) Attorney General initiated suits – three suits brought by the Attorney General of Ohio against GMAC, and the Attorneys General of Nevada and Arizona against Countrywide and Bank of America. Additional investigations have just recently been undertaken. Absent a settlement with the state Attorneys General, more suits by state Attorneys General are likely to be filed.

Although no major judgments have been rendered to date, most of these cases are in the initial phase of litigation. If judgments are rendered for plaintiffs in these cases they could materially forestall the foreclosure process and create considerable uncertainty. Absent resolution to the mortgage servicing practices, claims and investigations regarding past practices will continue to proliferate, likely deferring the recovery of housing and mortgage markets.

In regards to mortgage servicing operation performance, evidence to-date demonstrates that servicers continue to struggle to effectively manage loss mitigation programs. The most recent evaluation of some of the largest servicers participating in HAMP underscores this point. Four of the ten largest servicers were found to need "substantial improvement" with the remainder found to need "moderate improvement."[4] Among the reasons for the poor grades is a high rate of error in calculating borrower income. For example, the Treasury Department found that, in nearly one-third (31 percent) of its files, JPMorgan Chase miscalculated borrower income by more than five percent.[5] An accurate calculation of income is crucial in determining eligibility for a modification and for calculating the new payment.

The housing market cannot heal and recover until mortgage servicing and foreclosure problems are resolved and systems are adequate to the task at hand going forward. Recent data clearly indicates that the housing market and homeowners continue to face major challenges. Loans in foreclosure are increasing in length of time to process – as of December 2010, the time spent in foreclosure was 8.8 months compared with 3.9 months as of year end 2007.[6] While servicers completed almost 1.8 million mortgage modifications in 2010, including 512,000 HAMP modifications and 1.24 million proprietary modifications,[7] the pace of modifications has declined.[8] Coupled with the impact of the market uncertainty regarding the impact of allegations of past errors, this

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[4] "Making Home Affordable" monthly report for April.
[5] *Ibid*, page 25.
[6] FDIC analysis of Lender Processing Services data.
[7] Statement of Faith Schwartz, Executive Director, HOPE NOW Alliance Before the Financial Services Committee Hearing on "*Government Barriers to the Housing Recovery*" p. 3. (Feb. 16, 2011).
[8] FDIC analysis of HOPE NOW and Treasury data.

current shadow inventory of non-performing loans in the foreclosure process hinders the clearing of the housing market.

Best Practices for Mortgage Servicing

Improving mortgage servicing will take both market reforms and regulatory reforms. It is essential that the marketplace alter the incentive structure of the mortgage securitizations to promote effective servicing of both performing and non-performing loans. The Federal Housing Finance Agency and the U.S. Department of Housing and Urban Development have begun a process to rethink compensation structures for mortgage servicing. As they do so, it will be important to consider the implication of these compensation structures on small or community bank servicers, who have not demonstrated shortcomings associated with the large bank servicers.

In addition, the FDIC's own experience suggests the following common-sense servicing practices should be incorporated in mortgage securitizations and other servicing operations:

- Grant servicers the authority, and provide compensation incentives, to mitigate losses on residential mortgages to address reasonably foreseeable defaults and to take other appropriate action to maximize the net present value of the mortgages for the benefit of all investors rather than the benefit of a particular class of investors.
- Require the servicer to disclose any ownership interest of the servicer or any affiliate of the servicer in other whole loans secured by the same real property that secures a

loan included in the pool, and establish a pre-defined process to address any subordinate lien owned by the servicer or any affiliate of the servicer, if the first mortgage is seriously delinquent in order to eliminate any potential conflicts of interest.

- Establish a single point of contact to coordinate borrower communications, both oral and written, relating to collection, loss mitigation and foreclosure activities in a manner that ensures that communications are timely, effective and efficient and do not confuse a borrower or otherwise impair or impede loss mitigation activities.
- Provide sufficient staffing resources in the areas of loss mitigation, collateral management, collections, and foreclosure activity to ensure compliance with state and federal laws, regulations, policies, and servicing guidelines. Front-line employees working with borrowers, especially those who are candidates for modification, should receive sufficient training to ensure communications with borrowers are accurate and consistent.
- Maintain proper documentation. For example, a foreclosing entity should have possession of the original note and either a recorded mortgage or a recorded valid assignment of the mortgage before initiating the foreclosure process. The attestations in a foreclosure affidavit should comply with applicable local substantive, evidentiary, and procedural law and should contain: (a) facts explaining the basis for the personal knowledge of the affiant (e.g., job title, job position, job duties, how an affiant became familiar with the facts in the affidavit, etc.); and (b) assurances the affiant has reviewed supporting documents and records to ensure all necessary and proper documents for foreclosure in that jurisdiction are included.

Through the collective efforts of state and federal regulators, servicers will be expected to implement these and other practices. It is important that these efforts be aligned and coordinated to the extent possible in order to avoid inconsistency. This will require extensive consultation and cooperation among state and federal regulators and law enforcement agencies.

Conclusion

The mortgage servicing system over the past few years has ill-served all parties involved – borrowers, lenders, neighborhoods, and investors – and has impaired the health and recovery of the housing and mortgage markets. Accordingly, the FDIC has encouraged the Financial Stability Oversight Council to continue its efforts in examining the potential financial systemic risks surrounding mortgage servicing and foreclosures. Addressing the problems that have been uncovered is critical to reducing the risk of a wider disruption to the foreclosure process, a larger cloud of uncertainty over the ownership rights and obligations of mortgage borrowers and investors, and further significant claims against firms central to the mortgage markets.

Looking forward, we continue to work with our colleagues to develop a set of national servicing standards that will apply the lessons learned from the current crisis in order to better align interests and, we expect, produce better outcomes in the future.

Thank you for the opportunity to testify on these issues before you today. I would be happy to respond to your questions.

MORTGAGE
BANKERS
ASSOCIATION
Investing in communities

Statement of

David H. Stevens
President and Chief Executive Officer
Mortgage Bankers Association

House Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

Subcommittee on Oversight and Investigations

July 7, 2011

Introduction

Chairmen Capito and Neugebauer, Ranking Members Maloney and Capuano, and members of both subcommittees, thank you for the opportunity to testify on behalf of the Mortgage Bankers Association (MBA).[1] My name is David Stevens and I am President and CEO of MBA. Immediately prior to assuming this position, I served as Assistant Secretary for Housing at the U.S. Department of Housing and Urban Development (HUD) and Federal Housing Administration (FHA) Commissioner.

My background prior to joining FHA includes experience as a senior executive in finance, sales, mortgage acquisitions and investments, risk management, and regulatory oversight. I started my professional career with 16 years at World Savings Bank. I later served as Senior Vice President at Freddie Mac and as Executive Vice President at Wells Fargo. Prior to my confirmation as FHA Commissioner, I was President and Chief Operating Officer of Long and Foster Companies, the nation's largest, privately held real estate firm.

Thank you for holding this hearing on the important subject of mortgage servicing. I would like to provide some background information as a preface to my remarks, express support for the need for national standards, highlight what MBA has done so far in examining that need, recommend steps for the process of developing comprehensive servicing standards, and suggest principles for those standards.

Background

As the housing crisis evolved, industry and policymaker responses evolved along with it. An understanding of these developments and their context is crucial to a full appreciation of the challenges facing the mortgage industry as it works to help borrowers avoid foreclosure and in identifying viable long-term solutions.

The "Great Recession" was the most severe economic downturn that the United States experienced since the Great Depression of the 1930s. It led to the failure or consolidation of many of the country's leading financial institutions, and from January 2008 to February 2010, the U.S. economy lost almost 8.8 million jobs. The government reacted with unprecedented policy initiatives, both in terms of fiscal stimulus and other interventions, and monetary stimulus in the form of near zero interest rates and massive purchases of mortgage-backed securities and other assets.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

The housing and mortgage markets both contributed to and suffered from this crisis. Although not an exclusive list, several factors were at play: excessive housing inventory, lax lending standards that favored non-traditional mortgage products and reduced documentation, the easing of underwriting standards on the part of Fannie Mae and Freddie Mac, passive rating agencies and regulation, homebuyers chasing rapid home price increases, undercapitalized financial institutions, monetary policy that kept interest rates too low for too long, and massive capital flows into the United States from countries that refused to allow their currencies to appreciate.

According to the Federal Housing Finance Agency (FHFA), home prices nationally decreased a cumulative 11.5 percent during the past five years, with much larger cumulative declines of 40 to 50 percent in the states of Arizona, California, Nevada, and Florida, known throughout the crisis as the "Sand States." Household formation rates fell sharply in response to the downturn, with many families combining households and household expenses to save money. And consumers cut spending across the board, as they tried to rebuild savings after the shocks to their wage income and the declines in the stock market and housing values. The residual effects continue today; even though construction of new homes remains near 50-year lows, inventories of unsold homes on the market remain high, with nearly 4 million properties currently listed, and homebuyer demand remains weak.

Regardless of which factors caused the recession, we do know that the nature of the crisis changed over time. Initially, rising rates from the Federal Reserve and suddenly tighter regulatory requirements regarding subprime and non-traditional loan products stranded borrowers who had counted on being able to refinance loans in late 2006 and into 2007.

As a result, serious delinquency rates on subprime adjustable rate mortgage (ARM) loans (loans 90 days past due) increased by 50 percent in 2006 and then more than doubled through 2007.[2] Even before their first interest rate reset, these loans failed at unprecedented rates. Subprime ARMs originated from 2005-2007 have performed far worse than any others in recorded data.

Without access to credit for new buyers, home prices in the Sand States markets began to fall dramatically. With investors increasingly questioning loan performance, the private-label MBS market froze in August 2007 and has remained essentially paralyzed ever since. Compounding the problem, lending to prime, jumbo mortgage borrowers effectively stopped. As liquidity fled the system, fewer potential buyers could access credit, and home prices declined further. According to the National Bureau of Economic Research (NBER), the economy officially fell into recession in December 2007.

The unemployment rate in January 2008 was five percent. Eighteen months later, it would be nearly twice as high, following the near collapse of the financial sector in the

[2] MBA's National Delinquency Survey.

fall of 2008. From that point forward, joblessness and loss of income began to drive mortgage delinquencies and foreclosures. Serious delinquency rates on prime fixed-rate loans were at 1.1 percent in the beginning of 2008. By the end of 2009, they approached five percent. These loans were traditionally underwritten and well-documented with no structural features that impacted performance. Many borrowers simply could not afford their mortgage payments because they did not have jobs.

Important policy initiatives were launched during this period. Servicers began large-scale efforts to modify subprime and non-traditional loans. Initially, individual servicers and the GSEs undertook these efforts voluntarily, but government and industry efforts led to standardization of processes through the Home Affordable Modification Program (HAMP). HAMP also benefitted proprietary modification programs, which could leverage these standardized processes. Importantly, the HOPE NOW Alliance[3] estimates that, as of April 2011, over 3.8 million homeowners have received proprietary modifications since mid-2007. Another 7.4 million borrowers received other home retention workouts, including partial claims and forbearance plans, a key tool supported by the Obama administration to assist borrowers who are unemployed.[4] The Treasury Department and HUD also report that borrowers received an additional 731,451permanent HAMP modifications.[5] Almost 12 million home retention workout options have been provided to consumers in four years. This is a significant accomplishment that took significant manpower and coordination in the face of unprecedented turmoil in the mortgage servicing industry and servicers should be recognized for what they have accomplished despite the industry's problems.

However, other public policy efforts, such as those designed to delay the foreclosure process, have typically not been effective over the longer term. Frequently, there can be a tradeoff between late-stage delinquencies and foreclosure starts, as new regulatory or statutory requirements delay foreclosure starts one quarter, resulting in a temporary increase in the delinquency "bucket." In most cases, though, foreclosure starts rebounded in subsequent quarters as backlogs were drawn down.

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[3] Established in 2007, HOPE NOW is a voluntary, private sector, industry-led alliance of mortgage servicers, non-profit HUD-approved housing counselors and other mortgage market participants focused on finding viable alternatives to foreclosure. HOPE NOW's primary focus is a nationwide outreach program that includes 1) over five million letters to non-contact borrowers, 2) regional homeownership preservation outreach events offering struggling homeowners face to face meetings with their mortgage servicer or a counselor, 3) support for the national Homeowner's HOPE™ Hotline, 888-995-HOPE™, 4) Directing homeowners to free resources through our website at www.HOPENOW.com and 5) Directing borrowers to free resources such as HOPE LoanPort™, the new web-based portal for submitting loan modification applications.

[4] HOPE NOW, Data Report (April 2011).

[5] May 2011 Making Home Affordable Program Report http://www.treasury.gov/initiatives/financial-stability/results/MHA-Reports/Documents/May%202011%20MHA%20Report%20FINAL.PDF

In summary, the worst recession in memory has led to the worst mortgage performance in our lifetime. Servicers have been overwhelmed by national delinquency rates running four to five times higher than what had been typical during the prior 40 years for which MBA has data. In spite of these market circumstances, servicers have worked to help borrowers avoid foreclosure whenever possible.

MBA Supports the Concept of National Servicing Standards

Presently, servicers face an overwhelming multitude of servicing standards and rules, from federal laws such as the Real Estate Settlement Procedures Act (RESPA), Truth in Lending Act (TILA), and the Dodd-Frank Act – to name a few – to 50 state laws (plus the District of Columbia), local ordinances, federal regulations, state regulations, court rulings or requirements, enforcement actions, FHA requirements, Veteran Affairs (VA) requirements, Rural Housing Service (RHS) requirements, Fannie Mae standards, Freddie Mac standards, and contractual obligations, such as the pooling and servicing agreement (PSA). Almost every aspect of the servicer's business is regulated in some fashion, but the rules are not always clear, placing servicers in a position of having to guess as to the requirements. Also, the evolutionary nature of the housing crisis caused significant, near constant, changes in these rules. Since the introduction of HAMP, a substantial number of major changes and additions have been made to the program. Many recent judicial challenges to the well-settled law of ownership rights to notes and mortgages have placed the very basis of secured lending at risk by disrupting note holders' and investors' ability to enforce their security interests.

Adding to the complexity is the fact that no two servicing standards are alike. Fannie Mae, Freddie Mac and FHA guidelines may cover the same subjects, but the requirements differ for each. Each of the guidelines addresses foreclosure processes, outlining penalties for not performing specified collection and foreclosure procedures in particular stages of delinquency, foreclosure or bankruptcy. This results in the need for servicers to create specialized teams for each investor. FHFA has undertaken a project to align certain portions of Fannie Mae's and Freddie Mac's servicing guidelines and create uniform requirements. We applaud that effort. Over the years, the companies' standards, although covering the same topics, have moved farther apart, rather than closer together. While the ultimate outcome of the Alignment Project remains to be seen, the first steps appear promising, but have included additional complex requirements from both companies. These additional requirements will add considerable cost to the servicing industry at a time when servicers are already experiencing unprecedented volume.

Moreover, these changes are coming at a time when the industry is also receiving new servicing standards from the Treasury via the HAMP program, the Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), the Federal Reserve, the New York Banking Department, the yet to be announced 50 state Attorneys General (AG) coalition, individual AG offices in various states, and numerous other sources. There has also been congressional action and we anticipate future action by the Consumer Financial Protection Bureau (CFPB). Unfortunately, each of the parties mentioned has a different opinion on what the servicing standards should be, making it very difficult for servicers to implement what has already been issued.

State laws also play into the complexity of servicing regulation. Each of the 50 states and the District of Columbia has its own laws governing the foreclosure process and other servicing activities. Some states require judicial foreclosure proceedings while others are non-judicial foreclosure states. Thus, the servicer must manage the nuances of the laws in the various states through its servicing systems and work processes. MBA supports uniformity among judicial foreclosure laws and non-judicial foreclosure laws, which have historically been within the domain of the states.

As a result of the unprecedented volumes of non-performing loans during the current cycle, servicers have experienced difficulties in their ability to adjust systems and work processes quickly to meet the ever-changing regulatory environment, including changes to loan modification programs, and the time required to hire and train employees for these new processes. We believe a national servicing standard would be beneficial to streamline and eliminate overlapping requirements. However, a national servicing standard must be truly national in scope and not simply another standard layered atop the already overwhelming number of servicer requirements.

In developing servicing standards, we must also pay careful attention to the interdependence of servicing and the impact that changes to the system will have on the economics of mortgage servicing, tax and accounting rules and regulations, and the effect of the new requirements on Basel capital requirements and on the To Be Announced (TBA) market. Servicing does not operate in a vacuum; instead it is part of the broader ecosystem of the mortgage industry. When making changes to the current model we need to be mindful of unforeseen and unintended consequences that could result ultimately in higher costs for consumers and reduced access to credit.

MBA's Servicing Initiatives

On December 8, 2010, MBA announced the creation of a task force of key industry members to examine and make recommendations for the future of residential mortgage servicing. The Council on Residential Mortgage Servicing for the 21st Century is being led by MBA's Vice Chairman, Debra W. Still, CMB, President and Chief Executive Officer of Pulte Mortgage, LLC. In announcing the formation of the Council, MBA Chairman Michael D. Berman, CMB, stated, "The residential mortgage servicing sector has been operating in a time of unprecedented challenges, presenting us with a unique opportunity to explore potential improvements to business practices, regulations and laws affecting the servicing sector and consumers. As the national trade association representing the real estate finance industry, we will bring together industry experts to take a comprehensive look at the current state and ongoing evolution of residential mortgage servicing and make recommendations for the future."

The Council convened a one-day public session on January 19, 2011, in Washington, DC, titled, "MBA's Summit on Residential Mortgage Servicing for the 21st Century."

This summit brought together industry leaders, consumer advocates, economists, academics and policymakers who took a detailed look at the issues that have challenged the industry and started the process of identifying the essential building blocks for the future of servicing.

Keynote speakers and panelists at the summit discussed problems and perceptions from their respective vantage points. Many speakers identified the need for a national servicing standard, the need to change the compensation structure to better incent servicers in the area of dealing with non-performing loans, and the need for potential changes in laws and regulations related to foreclosures and other facets of servicing.

In analyzing the issues that surfaced during the summit, the Council identified three major areas for further study and development of policy recommendations:

- Review of existing servicing standards and practices especially in the areas of large volumes of non-performing loans, foreclosure practices, and loss mitigation practices, including loan modifications. The Council formed a working group to study and make policy recommendations related to a national servicing standard.

- Evaluation of the legal issues related to the foreclosure process, chain of title and other issues. The Council formed a working group to study and make policy recommendations related to legal issues surfaced during the Summit and any additional statutory or regulatory changes deemed appropriate for servicing in the 21st Century.

- Analysis of proposed changes in servicer compensation proposed by the FHFA, Ginnie Mae, Fannie Mae, and Freddie Mac. The Council formed a working group to analyze the proposed compensation structure from the vantage of various stakeholders including large and small servicers, depository and non-depository servicers, and portfolio lender/servicers and MBS issuer/servicers.

In May, MBA's Council released a white paper that serves as an educational tool and provides background information on the events leading up to the current crisis. The white paper outlines the typical functions of a mortgage servicer, describes how a servicer is compensated, and identifies the perspectives of consumers, regulators, and the legal community with regard to servicer performance in the current crisis and their policy recommendations. It also contains an industry analysis of the criticisms against servicers in order to separate real problems from "myths" that often drive the policy debate.

The "myths" document summarizes several issues and misperceptions raised by regulators and consumer groups that have crept into the public consciousness during the servicing debate and dialogue. For example, the document dispels beliefs that a servicer's compensation structure is misaligned and leads to servicers having greater incentives to foreclose on a delinquent borrower than to modify a loan.

On June 23, 2011, MBA's Council released its analysis on the various fee proposals currently under consideration by FHFA, Fannie Mae, Freddie Mac, and Ginnie Mae. As part of this release, MBA also recommended that the agencies add a new Reserve Account Proposal to their study and analyzed the benefits and drawbacks of this proposal. Under the Reserve Account Proposal, the new "normal servicing" fee would drop from 25 basis points to 20 basis points, but five additional basis points would be collected from mortgagor payments and set aside in a "trust" cash account. The amounts reserved would remain in the account for a specified period and used to pay for higher expenses associated with delinquent servicing. Servicers could recapture the funds based upon a specified seasoning, level of portfolio performance, and other factors deemed appropriate. The white paper and servicing fee analysis are included as part of this testimony.

MBA expects to have a preliminary recommendation with respect to national servicing standards later this year, as well as preliminary recommendations related to foreclosure laws, chain of title issues, and other legal and regulatory obstacles to the servicer doing its job in dealing effectively with borrowers in default.

Additional Industry Efforts

In addition to implementing the various loss mitigations programs, including HAMP, the industry has supported many other pro-consumer efforts:

- **Free Borrower Counseling[6]:** Many servicers and investors pay HUD-approved counselors to advise borrowers on options to avoid foreclosure. Housing counseling is also supported through NeighborWorks America and HUD grantees. These counselors are instrumental in helping to educate borrowers about specific program details and to collect documents necessary to complete loss mitigation evaluations. Counseling is free or low-cost to borrowers. HOPE NOW, of which MBA is a member, supports the Homeowner's HOPE™ Hotline, 888-995-HOPE™, which is managed by the non-profit Homeownership Preservation Foundation, and operates 24 hours a day, 7 days a week, in several languages. The hotline connects homeowners to counselors at reputable HUD-certified non-profit agencies around the country. From 2008 to May 2011, there have been more than 5.1 million consumer calls into the hotline, which serves as the nation's "go-to" hotline for homeowners at risk.[7] The U.S. government uses this hotline for its Making Home Affordable program and noted in its December 2010 report that 1.8 million calls have been fielded by the hotline.

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[6] MBA's Research Institute for Housing America recently released a study, 'Homeownership Education and Counseling: Do We Know What Works?' which examined the benefits of pre-purchase and post-purchase counseling.
http://www.housingamerica.org/Publications/HomeownershipEducationandCounseling:DoWeKnowWhatWorks.htm

[7] Homeownership Preservation Foundation , "888 995 HOPE National Activity Calls"

Unfortunately, funding was eliminated for the HUD Counseling Assistance Program in the Fiscal Year 2011 Appropriations Act. These cuts are worrisome because housing counseling provides significant benefits to consumers, especially during the current housing crisis. Last year, HUD reported that more than 2.1 million clients received one-on-one housing counseling from HUD-approved agencies. The grants awarded by HUD provide not only foreclosure prevention counseling but pre- and post-purchase counseling, renter counseling, reverse mortgage counseling for senior homeowners, counseling for homeless individuals and families seeking shelter, as well as training for counselors. As a result of the overwhelming demand for and value of housing counseling services, MBA urges Congress to restore $88 million in funding for the HUD Housing Counseling Program in Fiscal Year 2012.

- **HOPE LoanPort™ (HLP):** HLP is an independent non-profit created by HOPE NOW and its members as a data intake facility to improve efficiency and effectiveness of communications among borrowers, counselors, investors and mortgage servicers. HLP was created to help address the frustration among borrowers, policymakers, counselors and servicers in the document submission process. HOPE LoanPort's™ web-based system allows a uniform intake of an application for a loss mitigation solution though HAMP, all federal programs and proprietary home retention programs. It allows for all stakeholders to see the same information, in a secure manner, and delivers a completed loan package to the servicer for action. This web-based portal increases accountability, stability and security for submitted information and increases borrower confidence that their information will be reviewed and will not be lost. Servicer and counselor steering teams, working together have made the decisions on how best to create and improve the HOPE LoanPort™ system. This portal was designed by a core group of non-profits including NeighborWorks® America and HomeFree-USA, and six industry servicers who shared in this unique and important mission.

Recommended Steps in Developing National Servicing Standards

Several regulators have recently specified their own distinct standards regarding mortgage servicing, a trend that concerns MBA deeply. The state of New York implemented standards late last year for loans serviced in that state. The OCC released proposed standards, and has separately issued consent orders to specific banks, that impose servicing standards through enforcement action as opposed to the normal federal rulemaking process. The Federal Reserve and the OTS have likewise issued consent orders to banks and thrifts that they regulate, which contain similar prescriptive servicing requirements. Several state AGs have proposed a settlement with some larger servicers that would impose restrictive standards as an alternative to civil litigation.

Additionally, the SEC and the federal bank regulators are currently attempting to impose servicing standards in the proposed origination rules related to a qualified residential mortgage (QRM) under the Dodd-Frank Act. In order to be considered a QRM and exempt from risk retention requirements, the proposal would require compliance with certain servicing standards. Specifically, the QRM's "transaction documents" must obligate the creditor to have servicing policies and procedures to mitigate the risk of default and to take loss mitigation action, such as engaging in loan modifications, when loss mitigation is "net present value positive." The creditor must disclose its default mitigation policies and procedures to the borrower at or prior to closing. Creditors also would be prohibited from transferring QRM servicing unless the transferee abides by "the same kind of default mitigation as the creditor."

MBA is extremely concerned with the inclusion of servicing standards in a QRM definition. The QRM exemption was clearly intended under the Dodd-Frank Act to comprise a set of loan origination standards only. The specific language of the Act directs regulators to define the QRM by taking into consideration "underwriting and product features that historical loan performance data indicate lower the risk of default." Servicing standards are neither "underwriting" nor "product features," and while they may bear on the incidence of foreclosure, they have little, if any, bearing on default. Combining origination standards that terminate at loan closing and servicing standards that commence at closing and continue for decades in a single QRM definition is problematic, as the regulation must address two distinct functions and timeframes. Accordingly, MBA strongly believes they have no place in this proposal.

Embedding servicing standards within the proposed QRM regulations will have unintended consequences that could actually harm borrowers. Specifying a servicing standard as part of QRM is directly contrary to achieving a national standard, as QRMs would only represent a small share of the overall mortgage market. The proposal requires loss mitigation policies and procedures to be included in transaction documents and disclosed to borrowers prior to closing. Such a requirement codifies the servicer's loss mitigation responsibilities for up to 30 years at the time of origination. While servicers today have loss mitigation policies to address financially distressed borrowers, these policies continue to evolve as regulators' concerns, borrowers' needs, loan products, technology and economic conditions evolve. One need only look at the variety of recent efforts that have emerged during the housing crisis such as HAMP, the Home Affordable Foreclosure Alternatives, FHA HAMP, VA HAMP, and proprietary modifications. A further example is the different set of loss mitigation efforts necessitated by Hurricane Katrina. In both situations, inflexible loss mitigation standards would not have been in the best interest of homeowners or investors.

The QRM proposal is also likely to make servicing illiquid by combining "static" loss mitigation provisions in legal contracts and borrower disclosures with the inability to transfer servicing unless the transferee abides by those provisions, even if more borrower-friendly servicing options become available.

The proposal also calls for servicers to disclose to investors prior to sale of the MBS the policies and procedures for modifying a QRM first mortgage when the same servicer holds the second mortgage on the property. This adds another level of complexity to the concerns raised above, notwithstanding the irrelevance of these provisions to underwriting, origination, and statutory intent.

MBA believes that national servicing standards should start with a full analysis of existing servicer requirements and state laws on foreclosure. The new standards should be promulgated in a process that includes open dialogue with all stakeholders, including federal regulators, state regulators, consumer advocates, servicers, and investors in mortgages and MBS. MBA welcomes the opportunity to participate and play a constructive role in such a process.

Principles for National Servicing Standards

MBA believes that one consistent set of standards would be beneficial for servicers and consumers. In developing a national servicing standard, specific principles should guide decision making. We suggest, at a minimum, the following principles:

a. National Servicing Standards Must Be Truly "National"

Of paramount importance to the industry is that any national servicing standard be truly national and not just another layer on top of the myriad of existing obligations. Servicers would not have the burden of looking to varying standards created by different entities (e.g., federal regulators, state laws, government agencies, etc.). Servicers could reduce staff and third-party experts currently needed to follow, track and comprehend varying standards. Errors would be reduced. Consumers would benefit by reduced complexity and, ideally, easy-to-understand requirements.

b. Process Must Be Transparent and Involve Key Stakeholders

The process to create national servicing standards must include servicers and investors as these parties would ultimately implement the new standards, and such standards could potentially restrict servicing activities and impose additional costs. Although it is likely that the new CFPB will finalize the standards, given its expansive role in consumer protection, industry input is crucial to ensuring the standards are workable.

c. Process Must Recognize Existing Requirements

Servicers are subject to a multitude of laws, regulations and requirements. In many cases, remedies already exist for a majority of the perceived problems. In setting national standards, regulators should recognize these existing rules.

d. Rules Should Allow Flexibility to Deal with Market Changes

Rather than prescribe the exact methodology by which servicers must conduct their day-to-day operations, a national servicing standard should describe the ultimate result the government wishes to achieve. Servicers and investors would be allowed to devise the means to achieve the objective that best suits their business model and capital structure. Moreover, flexibility would allow servicers to address different market conditions and consumer needs. The best example to illustrate the importance of flexibility is by comparing today's borrowers' needs, whereby modifications are critical, or borrowers affected by Hurricane Katrina, for whom forbearances were paramount as they awaited hazard insurance and Road Home funds.

e. Standards Should Create Uniform and Streamlined Processes

Processes that servicers must follow need to be simple and uniform. Markets operate best with certainty, and servicers need straightforward processes that do not differ by product, investor, regulator or state. As stated above, one set of standards will limit errors and litigation risk, and promote customer satisfaction. Simple processes will yield the best results for all consumers and servicers.

f. Standards Must Treat Borrowers Fairly/Recognize Borrower Duties

MBA strongly believes that borrowers should be treated fairly and with compassion. Customers should obtain respectful service, should have access to the opportunities to retain homeownership for which they qualify, and should understand their options. We also believe that borrowers have duties. These include responding to servicer offers of assistance, contacting the servicer early in the delinquency, and diligence in providing required documents and other requirements of loan modification programs. These principles, for both the servicer and the borrower, must be recognized in the development of national servicing standards.

g. Standards Must Treat Servicers Fairly

National servicing standards should ensure the fair treatment of servicers and recognize the economic realities of the servicing business. Standards must recognize the costs of delinquency and foreclosure, including late fees and other compensatory fees necessary to offset the cost of delinquency. Many of the suggested standards question these charges, yet these fees are necessary to ensure quality customer service, to enable advance payments to bondholders as required, and to provide the loss mitigation products borrowers seek. We urge policymakers, therefore, to balance the needs of borrowers and servicers.

<u>Potential Components of National Servicing Standards</u>

Regulators, congressional leaders, consumer advocates and academics have proposed various servicing standards to address perceived problems, as well as borrower complaints. These proposals differ significantly, but the goals are consistent: to improve the customer's experience in the loss mitigation process, to avoid confusion, and to ensure that borrowers are treated fairly and given access to loss mitigation. We agree with these goals.

We would like to address several concepts currently under consideration as part of the dialogue concerning various proposed national standards.

a. Single Point of Contact

Some regulators and consumer advocates are promoting a single point of contact to simplify communications with servicers during the loss mitigation process. MBA supports clear and helpful communication with the borrower. However, a single point of contact may have unintended consequences, potentially leaving consumers more frustrated and with greater delays. There is no unified definition of "single point of contact." A plain English definition would imply that a single person would be assigned to each borrower and that the borrower would communicate only with this person. This is not feasible in the current environment and would create numerous problems as servicer call volumes fluctuate significantly throughout the day, week, and month.

First, a single point of contact eliminates the specialty training necessary to deliver accurate and timely assistance to borrowers, as borrower assistance may range from questions regarding their payment history or escrow processes to complicated modifications such as HAMP or short sales. A single person cannot be an expert in each of these highly complex and regulated areas. The result will be delays, miscommunication and/or errors.

Second, given the current environment, it will be impossible to have sufficient staff to meet the wildly fluctuating demands. Borrowers may be subject to significant delays and response times if limited to one individual. Even if a borrower were able to talk to other knowledgeable servicing team members, we are concerned that the borrower could decline and request a return phone call from the single point of contact. As a result, the borrower will suffer delays and frustration with regard to his or her issues and concerns.

Third, a single point of contact raises concerns regarding staff departures, work schedules, business travel, vacations, illness, etc. The reality is a single point of contact can never truly be a single person. In its purest sense, a single point of contact disrupts a servicer's efforts to provide the best service in a specific area of expertise. Borrowers must be willing to communicate with other staff familiar with the borrower's account, and servicers must have the flexibility to structure staff the best way to achieve superior customer service.

b. Dual Track

Some policymakers and consumer advocates continue to call for the elimination of so-called "dual tracking." Dual tracking occurs when the servicer continues intermediate foreclosure processes while loss mitigation activity is underway. Interim foreclosure processes, such as notices and rights to hearings, are required by state law or courts and would continue during preliminary loss mitigation efforts to ensure the borrower received due process and to avoid unnecessarily delaying foreclosure should the borrower not qualify. It is important to realize, however, that servicers *will not* go to foreclosure sale (e.g. the borrower will not lose the house) if the borrower has provided a complete loss mitigation package sufficient to evaluate the borrower for loss mitigation and has provided such information in a reasonable time before the foreclosure sale date.

Successful loss mitigation, however, requires diligence and priority on the part of the borrower. Borrowers should submit full application packages as soon as possible and prior to initiation of foreclosure. Servicers should not be expected to stop foreclosure processes, or even a foreclosure sale, if the borrower waits until the last minute to request assistance. Moreover, some courts do not allow a foreclosure sale to be cancelled within 7-10 days of the scheduled sale date.

The halting of the foreclosure process is difficult due to investor requirements. Fannie Mae, Freddie Mac and FHA all require servicers to meet various foreclosure timelines. Failure to meet these timelines, without a waiver, results in penalties to the servicer. For example, FHA requires that the servicer start foreclosure within six months of the date of default. Failure to meet this strict deadline by even one day, without a waiver, means the servicer does not get reimbursed for almost all of its interest costs (e.g., the accumulating arrearage).

Moreover, state laws often provide that various steps must occur at specific times – or expensive steps, such as newspaper publication, must be repeated at significant cost to the servicer, foreclosing attorney, government agencies and, in the event of government programs, taxpayers.

Delays have significant monetary impact on the investor and servicer. Delays extend the period of necessary advances a servicer must pay to investors, increase costs to government agencies due to larger claim filings, result in the loss of equity in the property if market values decline, and allow more time for the property to deteriorate. In addition to merely delaying foreclosure, a pause can result in real hard dollar costs, which today are not fully reimbursed to the servicer or the foreclosing attorneys who incur them. This is not a sustainable model and can result in millions of dollars of unreimbursed costs. A national standard must consider these cost issues.

c. Mandatory Principal Write-down

The issue of mandatory principal write-down continues to be suggested as a means to achieve affordability. While there is no doubt principal write-down promotes affordability, there are other means to achieve the same affordability without the disparate impact on servicers or note holders. Such options include rate and/or term modifications and principal forbearances. A principal forbearance takes a portion of the principal and sets it aside in calculating a reduced monthly mortgage payment. It is similar to a principal write-down, but appropriately gives a portfolio lender or investor the right to recoup the set aside principal at a later time, such as when the house is sold.

FHA HAMP and FHA partial claims are principal forbearance programs, and we believe they are effective tools.

The concept of mandatory principal write-down – as opposed to principal forbearance – is extremely problematic in secured credit transactions for the many reasons MBA has expressed in previous policy debates regarding Chapter 13 bankruptcies. The same issues surface if servicers are required to accept principal reductions over interest rate or term modifications or principal forbearances in the loss mitigation waterfall:

- First, the servicer is a mere contractor in the securitization function and thus cannot obligate the note holder or investor to take a permanent loss on the loan. Fannie Mae and Freddie Mac do not accept principal write-downs and FHA and Ginnie Mae do not reimburse for voluntary or mandatory principal write-downs. Servicers, therefore, cannot impose it.

- Second, with regard to private label securities, the securitization documents must specifically provide for this option or the servicer risks litigation. Most securitization transaction documents do not provide for principal write-downs, and some specifically prohibit principal write-downs. We understand there are differences in views from the various MBS tranche holders. Principal write-downs would benefit senior security holders to the detriment of subordinate holders. However, it is inappropriate to forcibly reallocate winners and losers in contradiction to the contract created to protect against these very default scenarios.

- Third, note holders and investors must be able to rely on the contractual terms of their mortgage agreements given the secured nature of a mortgage transaction. It is inequitable to mandate that secured note holders or investors must write down principal.

- Fourth, without statutory changes, mandatory principal write-downs by the servicer could eliminate government mortgage insurance[8] and private mortgage insurance[9] that currently protect servicers/investors against losses. If mandatory principal write-downs were required without a change to agency guidelines/statutes, servicers – not the investors – would be required to absorb the principal loss. This is an inappropriate role for servicers, which never priced their compensation to accept first dollar loss. However, servicers have been voluntarily writing down principal balances of loans when appropriate, particularly on loans they own, and will continue to do so.

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[8] Today, FHA insurance and VA guarantees protect the servicer against principal loss due to foreclosure. However, FHA and VA cannot pay the servicer a claim for principal reductions. Authorizing statutes do not permit it. Conversely, if the loan went to foreclosure, the servicer would have the benefit of the insurance/guarantees and not suffer a principal loss.

[9] Private mortgage insurance is comparable to government insurance in that it protects lien holders from principal loss in the event of foreclosure. Private mortgage insurance protections will be lost in the amount of the lien strip.

In sum, MBA opposes involuntary principal write-down and believes it will inhibit the housing market's recovery.

d. Misalignment of Servicer and Investor Incentives

Another common theme is that servicer incentives are misaligned with the interests of investors. While servicing compensation may not appropriately compensate the servicer for the multitude of additional requirements imposed on them during this crisis,[10] we believe there are significant incentives within the existing fee structure that encourage appropriate loss mitigation. Fannie Mae, Freddie Mac, and Ginnie Mae ultimately designed their programs and concluded that servicers should not be paid their servicing fee while the loan is delinquent. The theory is that if the servicer is not paid for managing the very expensive default process, they will expend resources to cure the delinquency or otherwise ensure cash flow – ultimately the goal of the investor. This incentive is real for the servicer.

The greatest financial incentive supporting modifications over foreclosures for servicers is the reinstatement of servicing income and the servicing asset. A modification immediately reinstates the servicing fee income and retains the servicing asset. Assuming a borrower remains current under the modified terms, the servicer will continue to receive its base monthly servicing fee income (25 basis points for GSE servicing and approximately 44 basis points for Ginnie Mae servicing) over the life of the loan. In contrast, such income ceases during the period of delinquency. In the case of GSE and FHA programs, the servicer never gets reimbursed the servicing fee if the loan goes to foreclosure. In private label securitizations, the servicing fee ultimately is reimbursed to the servicer when the Real Estate Owned ("REO") is sold, but the reimbursement is without interest. In summary, foreclosures result in an early termination or, in the case of private label securities, deferment of servicing fee income. Modifications, on the other hand, result in the immediate reinstatement and continuation of such servicing income. Also, the continuation of servicing fee income through a loan modification or other cure provides retention of the servicing asset that is otherwise written off upon foreclosure.

Modifications also stop costly advances of principal, interest, tax, insurance and other expenses, such as property preservation costs, and provide for quick reimbursement of these outstanding advances. In the case of private label securities, servicers generally must advance principal and interest from the due date of the first unpaid installment until the property is liquidated through the sale of REO. According to LPS's Mortgage Monitor Report (data as of May 2011), the average length of time a loan was delinquent when it reached foreclosure sale was nearly 580 days. The average number of days a

[10] Fannie Mae, Freddie Mac and FHA recognized over a decade ago that servicers could reduce their losses by performing "extraordinary" servicing, which involved very complex loss mitigation options. MBA was involved in those discussions, which ultimately resulted in the incentive payments for successful loss mitigation efforts. Unfortunately loss mitigation has become even more complex, with the agencies requiring more and more from servicers and foreclosure attorneys without compensation. This is not appropriate and, thus, we agree that some additional compensation is required. Investor contracts should not impose unlimited cost burdens on servicers.

property remains in REO is in the range of 116-176 days, according to Clear Capital and the Five Star Institute. In many cases, the servicer does not receive full reimbursement for those advances. For example, FHA curtails 60 days of interest advanced and one-third of foreclosure attorneys' fees on all foreclosure claims. The GSEs also curtail property preservation expenses and attorneys' fees when foreclosure steps must be repeated due to a foreclosure pause. In sum, servicers are incented to modify the loan to reduce the interest costs and capital allocation associated with carrying advances.

<u>Conclusion</u>

MBA supports reasonable national servicing standards that apply fair practices for borrowers, servicers and investors alike and that seek to eliminate the patchwork of varying federal, state, local and investor requirements. However, national servicing standards must be truly national. Creating different state and local requirements would only compound the complexities servicers already face within current market conditions.

Servicers must also be included as stakeholders in the development of the standards. It is important to understand why processes are in place to avoid unintended consequences. Existing standards should be given careful consideration before being replaced. Servicers' use and development of successful loss mitigation efforts to date should also be acknowledged.

We recognize that our industry can and must do better. Given the overwhelming nature of the crisis and the ever-changing requirements, servicers have tried to meet competing obligations in a rapidly changing environment, and we believe that national servicing standards can help us accomplish the goal of preventing foreclosures whenever possible.

At the same time, in moving toward national servicing standards, policymakers must fully recognize the economics of mortgage servicing and balance laudable public policy goals against business and market realities. Our industry stands ready to play a constructive role in the dialogue about how best to achieve this balance.

Written Testimony of Alabama Attorney General Luther Strange
Joint Hearing of the Subcommittee on Financial Institutions and Consumer Credit and the Subcommittee on Oversight and Investigations
"Mortgage Servicing: An Examination of the Role of Federal Regulators in Settlement Negotiations and the Future of Mortgage Servicing Standards"
Thursday, July 7, 2011 10:00 AM

Chairmen Capito and Neugebauer, Ranking Members Maloney and Capuano, and members of the Subcommittees:

My name is Luther Strange, and I am the Attorney General of the State of Alabama. Thank you for inviting me to testify today on the ongoing settlement negotiations with the mortgage servicing companies.

In October of 2010, the Alabama Attorney General's Office joined the 49 other state Attorneys General and state banking and mortgage regulators in more than three dozen states in an investigation into allegations that mortgage companies mishandled documents and violated laws when they foreclosed on homeowners across the United States (the "Foreclosure Multistate Working Group").

Like twenty-six other states, Alabama is a nonjudicial foreclosure state. A mortgage holder must provide publication notice of the foreclosure for three successive weeks in a local newspaper, and the foreclosure must take place on the date provided in the foreclosure notice at the applicable County courthouse steps during a statutorily specified time. Alabama law provides for a one year right of redemption following the date of the foreclosure. To redeem the property, the prior owner must pay the mortgage holder or subsequent owner the purchase price paid at the foreclosure plus statutorily allowable interest.

In March of this year, the Foreclosure Multistate Working Group submitted a term sheet to the nation's largest mortgage servicers, which was presented as a draft agreement on behalf of Attorneys General and other state and federal agencies, and was intended to settle allegations related to improper foreclosure practices and loan servicing. The servicers have responded to the term sheet and negotiations are currently underway between the States, the federal government and the mortgage servicers.

As I review any potential settlement agreement, I am guided by three overarching principles. First, the settlement must hold the mortgage servicers accountable for unlawful and deceptive practices under state law. Second, Attorneys General are not responsible for legislating and setting policy, and the settlement agreement should not attempt to overreach into the area of state and federal policy decisions. Third, the settlement must contain provisions that discourage and deter future illegal activity. This final principle is the most crucial.

Above all else, unethical mortgage servicers, and any other bad actors in the mortgage servicing industry, must be held accountable for any unlawful or deceptive practices they engaged in. Certain aspects of the term sheet, such as those dealing with single point of contact (SPOC), "dual-track" foreclosures, robo-signing, and verification of account information, contain many changes in practice that are beneficial to consumers. Enforcement agencies and the entire industry should have a vigorous debate on these proposals. My staff and I take our duty to protect consumers seriously, and we will work to investigate and prosecute bad actors to the fullest extent of the law. Any fines or penalties assessed on the servicers pursuant to a settlement agreement should be linked, and in response, to specific, documented violations of state and federal law.

I want to thank Attorney General Miller for his tireless efforts and leadership of the Foreclosure Multistate Working Group. Protecting consumers, like many other goals of the Foreclosure Multistate Working Group, is not only laudable, it is something that I consider my highest duty. But I am concerned that what started out as an effort to correct specific practices harmful to consumers has evolved into an attempt to establish an overarching regulatory scheme that fundamentally restructures the mortgage loan industry in the United States – an effort which is well beyond the scope of responsibility of Attorneys General. I would like to take the remainder of my time to address some specific concerns I have.

First, any ultimate settlement must not preempt state law sovereignty. Alabama, like many other states, has made the policy decision to permit nonjudicial foreclosures. I am skeptical of any agreement that overrides my State's decision by imposing requirements that essentially make all states subject to the judicial foreclosure process without a legislative mandate. The legislative process in Alabama has also yielded certain consumer protection laws that my Office is charged with enforcing, such as the Deceptive Trade Practices Act. The causes of action under those statutes were the result of legislative deliberation, and any new causes of action related to the mortgage foreclosure situation should also be the result of legislation, not a settlement agreement.

Second, mandated principal reduction is bad public policy and creates questions of fundamental fairness and justice. Hard working folks throughout the country are currently underwater on their mortgages, but they work every day to pay their debts. Mandated principal write-down would create an incentive for these homeowners to default and seek a reduction. Requiring lenders to reduce mortgage balances would remove incentives for banks to lend money and for investors to purchase mortgages, denying people access to the credit they need to purchase a home. Mandatory principal write-down would negatively impact an already devastated housing market, reduce home loans, and potentially put home ownership out of reach for millions of Americans. In 2009, both the House and Senate rejected amendments that would have permitted bankruptcy judges to "cram-down" home loan principal. We should not attempt to legislate this rejected policy through a settlement agreement.

Third, a settlement must not impair an efficient foreclosure process that clears local markets and facilitates economic recovery. I am very skeptical of any settlement that forces servicers to violate contracts with mortgage owners and abrogates the rights of second lien holders. Terms such as these could have serious unintended consequences. Unfortunately, there are many mortgages for which it is clear a modification is not feasible. These homes are often vacant and depress home values, and an efficient foreclosure process is essential to clearing these homes from the market.

Finally, a settlement must not impose onerous regulatory burdens on community banks. Alabama has over 130 community banks that are an important economic driver of the state. Community banks focus attention on the needs of local families, businesses, and farmers. Community banks channel most of their loans to the neighborhoods where their depositors live and work, helping to keep local communities vibrant and growing. I am very concerned about the effects of an ultimate settlement on these community banks. We must not increase their regulatory burden when it is clear they generally were not engaged in the conduct giving rise to the investigation.

Thank you again for holding this important hearing, and I look forward to answering your questions.

For Release Upon Delivery
10:00 a.m., July 7, 2011

TESTIMONY OF

JULIE L. WILLIAMS
FIRST SENIOR DEPUTY COMPTROLLER AND CHIEF COUNSEL
OFFICE OF THE COMPTROLLER OF THE CURRENCY

Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

And

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

Of the

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

July 7, 2011

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Chairman Capito, Chairman Neugebauer, Ranking Member Maloney, Ranking Member Capuano, and members of the Subcommittees, I appreciate the opportunity to provide information on recent developments related to our enforcement actions against several large servicers to address defects in mortgage servicing and foreclosure processes and other concerns, and to describe the recent initiatives the Office of the Comptroller of the Currency (OCC) has undertaken related to mortgage servicing.

My testimony focuses on three areas. First, I will describe the examinations conducted by the OCC and other federal banking agencies to investigate irregularities in the foreclosure processes of several major mortgage servicers and the cease and desist orders that the OCC, Federal Reserve Board (FRB), Federal Deposit Insurance Corporation (FDIC), and Office of Thrift Supervision (OTS) issued following those examinations. The Cease and Desist Orders (Orders) contain a number of substantive provisions affecting mortgage servicing and foreclosure processes. They require detailed Action Plans that will revamp major aspects of the servicers' mortgage servicing and foreclosure operations. As part of that, the Orders also require a comprehensive independent review of foreclosure actions, and the establishment of a public complaint process, to identify and compensate borrowers who suffered financial harm. My statement will describe generally our examination findings and discuss the content and implementation of these Orders.

Second, I will discuss the relationship between implementation of our enforcement Orders and separate negotiations that are being conducted with servicers by other federal and state agencies and how these discussions and other developments affecting mortgage servicers will drive changes in mortgage servicing practices. New requirements imposed by federal law and changes recently announced by the government sponsored enterprises (GSEs) also will be significant factors in shaping mortgage servicing practices going forward. My statement briefly describes these developments.

Finally, given the variety of initiatives underway by different parties to address defects in, and to improve, component parts of the mortgage servicing business, the OCC agrees that a public policy objective should be a coordinated effort to develop comprehensive, uniform national servicing standards that apply to all aspects of loan servicing, from loan closing to payoff, and that apply to all servicers. Lenders, servicers, investors, and consumers would benefit from strong national standards regulating mortgage servicing practices. Such an initiative currently is underway, and my statement reports on the actions being taken by the OCC and other federal agencies to develop uniform federal standards for mortgage servicing.

I. Foreclosure Processing Examinations and OCC Cease and Desist Orders

In the fall of 2010, following reports of irregularities in the foreclosure processes of several major mortgage servicers, the OCC directed the largest national bank servicers to conduct self-assessments to identify any problems related to foreclosure processing. Concurrently, the OCC, together with the FRB, FDIC, and OTS, coordinated efforts to conduct "horizontal" examinations of foreclosure processing at the 14 largest federally regulated mortgage servicers during fourth quarter 2010.[1]

[1] The federal banking agencies conducted foreclosure-processing examinations at Aurora Bank, Bank of America, Citibank, EverBank, GMAC/Ally Bank, HSBC, OneWest, JPMC, MetLife, PNC, Sovereign Bank, SunTrust, US Bank, and Wells Fargo.

The primary objective of the examinations was to evaluate the adequacy of controls and governance over bank foreclosure processes, including compliance with applicable federal and state law. Examiners also evaluated bank self assessments and remedial actions as part of this process, assessed foreclosure operating procedures and controls, interviewed bank staff involved in the preparation of foreclosure documents, and conducted an in-depth review of approximately 2,800 borrower foreclosure cases in various stages of foreclosure. Examiners focused on foreclosure policies and procedures; organizational structure and staffing; vendor management of third parties, including foreclosure attorneys; quality control and audits; accuracy and appropriateness of foreclosure filings; and loan document control, endorsement, and assignment. When reviewing individual foreclosure files, examiners checked for evidence that servicers were in contact with borrowers and had considered alternate loss mitigation efforts, including loan modifications, in addition to foreclosure.

In general, the examinations found that the loans in the sample were seriously delinquent. However, the examinations also found that there were critical deficiencies and shortcomings in foreclosure governance processes, foreclosure document preparation processes, and oversight and monitoring of third party law firms and vendors at each of these servicers. These deficiencies constitute unsafe and unsound banking practices, which also resulted in violations of foreclosure laws, regulations, or rules. By emphasizing timeliness and cost efficiency over quality and accuracy, examined institutions fostered an operational environment that is not consistent with conducting foreclosure processes in a safe and sound manner. All servicers exhibited some deficiencies, although the number, nature, and severity of deficiencies varied by servicer.

The sample of foreclosures reviewed as part of the interagency horizontal examination was adequate to expose serious flaws and unsafe or unsound practices in banks' foreclosure processes and provided a basis for enforcement actions. It could not, of course, identify the universe of borrowers that might have been financially harmed by those deficiencies. Identification of and providing financial remediation to those borrowers is a primary objective of the recent enforcement actions issued against the mortgage servicers by the OCC and the other federal banking agencies.

On April 13, 2011, the OCC, along with the FRB, FDIC, and OTS, announced the issuance of Cease and Desist Orders against each of the 14 servicers subject to our respective jurisdictions, and two service-providers reviewed as part of the horizontal examinations. The Orders are intended to correct the deficiencies the agencies found both in mortgage servicing and foreclosure processing, which the OCC found to be unsafe and unsound banking practices. The OCC's enforcement actions address the full range of deficiencies found during the horizontal examination and require remedial actions by the banks to ensure that the foreclosure process, from beginning to end, is administered in a transparent, fair, and safe and sound manner. While the Orders are geared toward fixing what is broken, they also contain measures requiring bank servicers to identify and compensate borrowers who suffered financial harm as a result of deficiencies in past foreclosure practices.

The OCC's Orders are broad in scope and require real reform to restore integrity to the foreclosure process. They require national bank mortgage servicers to implement a comprehensive revision of their loan modification and foreclosure processes. The Orders address the elimination of dual tracking, once a modification has been approved, and the establishment of a single point of contact system to ensure borrowers can contact a live person throughout the process. The Orders require robust oversight and controls of third-party vendors, including outside legal counsel and vendors who provide default and foreclosure processing services to ensure that those who act on their behalf comply with these obligations as well as all laws and regulations, both state and federal.

It is important to understand that while the Orders themselves impose comprehensive requirements, the Orders are structured to require detailed Action Plans to be submitted by each servicer to implement those requirements. Thus, while the Orders set forth a substantial framework, that framework will be filled in with the plans submitted by the servicers. Those Action Plans must be acceptable to each servicer's primary banking regulator. In several important areas, those Action Plans cover activities that are also the subject of negotiations being led by the Department of Justice (DOJ), involving other federal and state agencies. Thus, as discussed below, the OCC has maintained a regular dialogue with DOJ to facilitate, where possible, synchronization of the implementation of our Orders with the results of those negotiations.

One of the more significant aspects of the Orders are the "look-back" provisions, which require a comprehensive, independent review of foreclosure actions for borrowers who completed, or were in the process of, a foreclosure during the period of January 1, 2009 through December 31, 2010 ("in-scope borrowers"). The look-back requires mortgage servicers to identify those borrowers that suffered financial harm as a result of foreclosure processing deficiencies and to compensate them for financial injury. This is an open-ended obligation, with no dollar cap, and the OCC is supervising compliance with the foreclosure review very closely.

The look-back work will be done by independent firms under plans contained in detailed engagement letters submitted to and which must be approved by the appropriate federal banking agency. These firms must have sufficient expertise and resources to conduct the foreclosure reviews. In addition, these firms are required to operate independently and avoid interests or priorities that conflict with areas addressed in the Orders such as, for example, prior representation of the servicer on the same matters under review. As a condition of OCC approval, firms seeking to perform the independent foreclosure review work also are required to specify in their engagement letters with the servicer that their foreclosure review work will be subject to the direction of the OCC and not the direction, control, or influence of the servicer. We have required specific terms in each engagement letter to assure this.

Pursuant to the requirements of the Orders, the independent review will achieve identification of harmed borrowers covered by the look-back period through two distinct means: 1) a public complaint process which will provide in-scope borrowers who believe they may have suffered financial harm as result of the banks' foreclosure process with the opportunity to have their complaint reviewed by the independent consultant; and 2) a sampling of loans to uncover, for example, borrowers in high risk segments, as discussed below.

The requirements of the OCC's look-back build upon techniques normally undertaken in remedying financial harm to victims as part of a class action lawsuit. The OCC intends to require mortgage servicers to deliver notice letters to every in-scope borrower covered by the look-back period to inform them of their right to have their complaint reviewed by an independent consultant. Skip tracing methods will be used to locate borrowers and multiple attempts to reach borrowers will be required for any returned notices. Servicers will be required to undertake a broad range of efforts to reach borrowers through methods such as national and local advertising campaigns and outreach efforts to community organizations. There will also be outreach to state attorneys general, Department of Justice (DOJ), and other federal regulatory agencies to solicit information about borrowers who may have filed foreclosure-related complaints with those authorities in the 2009 and 2010 time period. All borrower complaints will be logged in, and documented, and their resolution reported to these agencies at the conclusion of the review.

In addition to this step, the federal banking agencies are requiring the independent consultants to conduct a targeted review of high risk segments, so that borrowers who either cannot be reached or fail to respond to the bank's notice letters might still have an opportunity to be captured under the look-back and to have the independent consultant determine if actions taken by the bank inflicted financial harm upon them. The sampling methodology must be robust and be targeted to detect borrowers most at risk of harm. This involves the segmentation of different borrower populations for separate reviews using statistically sound sampling techniques. Such segments would include, for example, a review of covered borrowers who were denied a loan modification, whose foreclosures were handled by law firms suspected to operate as "foreclosure mills," who were handled by a particular processing center, or who submitted a foreclosure-related complaint to the servicer. Certain borrower segments will require 100 percent review including, but not limited to, borrowers protected by the Servicemembers Civil Relief Act and borrowers in bankruptcy whose mortgage was foreclosed upon and whose home was sold. Independent consultants that conduct this review will be required to make a number of determinations including, but not limited to, whether the servicer properly documented ownership of the loan, whether foreclosures complied with applicable state and federal law, whether the borrower was charged fees in excess of those that are reasonable and customary and permissible under the terms of the note and applicable law, and whether any applicable loan modification and loss mitigation requirements were followed.

The OCC will oversee this process to ensure that the look-back process is conducted in an independent manner. In addition, the OCC will take all steps necessary to ensure that any foreclosure problems identified through our examinations, the look-back process, and the public complaint process are rectified, and that the banks address financial injury suffered by borrowers as a direct result of such foreclosure deficiencies. We expect to provide a public interim report on the look-back process once the details the look-back are finalized, and then to provide a public report on the results at the end of the process.

II. Interagency Coordination and the Changing Landscape Affecting Mortgage Servicing

From the beginning of the horizontal examination, to the issuance of the enforcement Orders, and to the implementation of the corrective action under the Orders, the OCC has been in regular communication with other federal and state agencies, including the DOJ. As you know, the DOJ is coordinating efforts of a group of other federal agencies and state attorneys general who are seeking a settlement with the bank servicers to address a variety of servicing issues.

In April, the federal banking agencies concluded that it was necessary to issue their enforcement Orders to address the serious safety and soundness concerns identified during the horizontal examinations and get the processes started for providing financial remediation to harmed borrowers. We determined that to delay the enforcement actions further might expose additional borrowers to harm, and leave these safety and soundness concerns unaddressed.

We recognized, however, and discussed with the DOJ, how the detailed Action Plans required under the Orders, particularly for mortgage servicing and foreclosure procedures, had the potential to synchronize with elements of the settlement being discussed involving the same bank servicers, state attorneys general, and certain other federal agencies. It was understood that the timing for submission of the detailed Action Plans required under our Orders had the potential to coordinate with – and could encourage – resolution of issues in areas where the scope of our Orders overlapped with matters in the settlement discussions being led by DOJ. Most recently, on June 13, 2011, the OCC, FRB, and OTS announced a 30-day extension of certain timelines under the Orders – at the request of DOJ to allow that process of coordination of servicer actions to continue. We continue a constructive dialogue with DOJ on these subjects. On other aspects of the settlement discussions being led by DOJ, our communications have focused on conveying any safety and soundness issues that raised concerns.

A key goal here ought to be to arrive at a common set of detailed servicing and foreclosure procedures that are consistent with safe and sound banking practices and fair to borrowers. We expect that our Orders and any agreements that may be entered into by servicers with other federal or state authorities will change servicing procedures for millions of mortgage loans. These initiatives guarantee that servicers will be subject to more rigorous standards and that borrowers will receive substantially more protections.

Therefore, in our interagency consultations, we have strongly urged that the discussions produce a common set of standards that servicers can follow to meet the terms of these agreements as well as any other applicable requirements, such as GSE standards described below – rather than result in multiple, conflicting, or inconsistent standards. That result would raise concerns of execution risk on the part of servicers and confusion on the part of borrowers. In addition, the newly announced GSE standards are particularly important to take into account in this regard, since those standards, for the foreseeable future, will govern an overwhelming preponderance of the mortgage market.

I describe those standards, and several other developments that will meaningfully impact the mortgage business going forward, below.

Changes in Federal Law: Dodd-Frank Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) has several provisions that will affect mortgage servicing practices. For example, the Dodd-Frank Act made several amendments to the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA) that will change a variety of mortgage servicing practices. TILA and RESPA are among the "enumerated consumer laws" for which rulemaking authority will be transferred to the Consumer Financial Protection Bureau (CFPB) on July 21, 2011.

TILA has new provisions requiring that periodic notices be provided to borrowers disclosing information related to the servicing of the loan, such as a statement of remaining principal balance and the amount of any prepayment penalty that may be imposed. Under the amendments, TILA also prohibits the imposition of a fee to provide a statement of balance due or to modify a high cost mortgage; imposes new requirements concerning the establishment and disclosure of escrow accounts for a variety of mortgages; requires creditors and servicers to provide timely payoff notices; and requires that payments be credited as of the date of receipt.

RESPA has new provisions regulating the force-placement of hazard insurance; requiring servicers to respond to borrower complaints about servicing errors in a timely manner; and requiring servicers to provide contact information for the owner or assignee of the mortgage. RESPA also has been amended to prohibit a servicer from failing to comply with "any obligation found by the [CFPB] to be appropriate to carry out the consumer protection purposes of [RESPA]."

Another provision of the Dodd-Frank Act requires the Secretary of HUD and the Director of the CFPB, in consultation with the federal banking agencies, to create and maintain a new database containing information reported by servicers about delinquent loans and loan foreclosures on a census tract basis. Finally, the Dodd-Frank Act authorizes the CFPB to issue regulations that identify as unlawful "unfair, deceptive, or abusive" acts and practices in connection with mortgage servicing.

Changes in GSE Guidelines

In addition to these new requirements under federal laws, Fannie Mae and Freddie Mac have announced two major initiatives related to servicing that will have widespread market impact. The first, announced in January, is a joint initiative with the FHFA and

HUD to develop new servicing compensation structures that improve the system for paying servicers of single-family loans in mortgage-backed securities pools. According to the GSEs, the current structure for servicer compensation has resulted in generous levels of compensation for work related to servicing pools of performing loans, but insufficient compensation when the servicing pool includes a significant number of non-performing loans. The stated objectives of this initiative are to align compensation structures to improve service for borrowers, reduce financial risk, provide flexibility in servicing non-performing loans, and promote liquidity in the mortgage securities market.

The second GSE initiative, announced in June, is to develop uniform policies for servicing delinquent loans that will enhance and streamline outreach to delinquent borrowers and establish performance-based monetary incentives for compliance. This initiative also will address the "dual track" issue by requiring servicers to focus solely on remediation of a loan delinquency and foreclosure prevention prior to initiation of a foreclosure action. Pursuant to this initiative, Fannie Mae issued new servicer requirements on June 6, 2011 (effective on September 1, 2011), and Freddie Mac issued its new servicing requirements on June 30, 2011 (effective on October 1, 2011). When these guidelines take effect, a foreclosure will not be permitted on a mortgage owned or guaranteed by Fannie Mae or Freddie Mac until after the servicer has conducted a formal review of the borrower's eligibility under all available foreclosure alternatives, including loan modifications, short sales, and deeds in lieu of foreclosure. A servicer of a mortgage that is in foreclosure also will be expected to continue to help these borrowers qualify for a foreclosure alternative. Given the significance of the GSEs to the mortgage market, these new standards will act as the catalyst for conforming changes in servicing standards for delinquent loans nationwide.

Changes in Capital Rules

The new Basel III framework also may affect the mortgage servicing business in significant ways by requiring that servicing rights beyond relatively modest levels must be deducted from capital for regulatory capital calculations. Under current capital rules, mortgage servicing assets can be included in Tier 1 capital up to a maximum of 100 percent of Tier 1 capital, subject to certain limitations. Under Basel III, however, the maximum amount of mortgage servicing assets that may be included in Tier 1 common equity capital – a new regulatory capital measure – will be capped at 10 percent, subject to certain limitations, and any assets in excess of 10 percent will be deducted from Tier 1 common equity capital. This change will have the effect of increasing the capital requirements for mortgage servicers and will thereby change to some degree the economics of the mortgage servicing business for firms that are subject to these capital standards. How this will affect the participants in and pricing of this business remains to be seen.

III. Need for Uniform Mortgage Servicing Standards

Against the backdrop of these changes in the regulatory landscape affecting mortgage servicing, which arise from multiple sources – including enforcement actions, changes in the law, and changes in GSE requirements – a key public policy objective should be the coordinated development of uniform mortgage servicing standards. Recent experience highlights the need for uniform standards for mortgage servicing that apply to all facets of servicing the loan, from loan closing to payoff or foreclosure. To be meaningful and effective, the OCC believes that mortgage servicing standards should apply to all mortgage servicers and provide the same safeguards for consumers, regardless of the size or business structure of the servicer or whether a mortgage has been securitized.

A number of months ago, to further this effort and initiate interagency discussions, we developed a framework for comprehensive mortgage servicing standards that we shared with other agencies, and other agencies put forward their recommendations as well. There is now underway an active interagency effort to develop a set of comprehensive, nationally applicable mortgage servicing standards. Participating agencies in the effort include the OCC, the FRB, the FDIC, the OTS, the Federal Housing Finance Agency, the Department of Housing and Urban Development (including the Government National Mortgage Association (Ginnie Mae)), the CFPB, and the Department of the Treasury. The agencies' objective is to develop uniform standards that govern processes for:

- Handling borrower payments, including applying payments to principal, interest, taxes, and insurance before they are applied to fees, and avoiding payment allocation processes designed primarily to increase fee income;
- Providing adequate borrower notices about their accounts and payment records, including a schedule of fees, periodic and annual statements, and notices of payment history, payoff amount, late payment, delinquency, and loss mitigation;

- Providing an easily accessible single point of contact for borrower inquiries about loss mitigation and loan modifications;
- Responding promptly to borrower inquiries and complaints, and promptly resolving disputes;
- Providing an avenue for escalation and appeal of unresolved disputes;
- Effective incentives to work with troubled borrowers, including early outreach and counseling;
- Making good faith efforts to engage in loss mitigation and foreclosure prevention for delinquent loans, including modifying loans to provide affordable and sustainable payments for eligible troubled borrowers;
- Implementing procedures to ensure that documents provided by borrowers and third parties are maintained and tracked so that borrowers generally will not be required to resubmit the same documented information;
- Notifying borrowers of the reasons for denial of a loan modification, including information on the NPV calculation;
- Implementing strong foreclosure governance processes that ensure compliance with all applicable legal standards and documentation requirements, and oversight and audit of third party vendors;
- Eliminating "dual track" processes where legal steps to foreclose on a property or conduct a foreclosure sale go forward even when a borrower has completed an application for a loan modification or is in a trial or permanent modification and is not in default on the modification agreement; and

- Ensuring appropriate levels of trained staff to meet current and projected workloads.

Staff from the participating agencies meet on a weekly basis to discuss different facets of mortgage servicing. Most of the meetings to date have been focused on monitoring the various new initiatives I described above relating to servicing of non-performing loans and foreclosure prevention. In this regard, it seems clear to all participants in this project that these initiatives, as well as any servicing-related obligations arising from the terms of any agreements between servicers and federal or state authorities, will influence the contours and content of any national standards we propose.

Going forward, we hope standards will be issued to address all aspects of mortgage servicing in the form of enforceable regulations that apply to all servicers. These rules could be supplemented with interagency compliance guidelines that can be used to fill in details and provide illustrations of practices that comply with the regulatory standards. Any proposed new regulatory standards will be published for public comment.

Our objective is to establish rigorous, uniform "rules of the road" for responsible servicer conduct that will be effective in this market as well as in the future. It is vital that any standards that the agencies adopt apply to and are implemented by all firms engaged in mortgage servicing – not just federally regulated depository institutions -- and that there is strong oversight of all servicers' compliance.

IV. Conclusion

The OCC is committed to ensuring that defects in servicing practices identified through our examinations are rectified, and that, through the look-back process, servicers address financial injury suffered by borrowers as a result of those defective practices. However, issues with the mortgage servicing business extend beyond defects in procedures with respect to foreclosure processing or non-performing loans. The OCC therefore strongly supports the development of national servicing standards that will significantly improve customer treatment in all aspects of mortgage servicing. We are actively working on an interagency basis to accomplish that objective.

I appreciate the opportunity to appear before the Subcommittees this morning, and I look forward to addressing your questions.

For release on delivery

10:00 a.m. EDT

July 7, 2011

Statement for the Record

Board of Governors of the Federal Reserve System

Submitted to the House Financial Services Subcommittees

On

Financial Institutions and Consumer Credit

and

Oversight and Investigations

United States House of Representatives

Washington, D.C.

July 7, 2011

Introduction

Chairman Capito, Chairman Neugebauer, Ranking Member Maloney, Ranking Member Capuano, and members of the Subcommittees, thank you for inviting the Federal Reserve Board to submit a statement for the record on the role of federal regulators in addressing the ongoing mortgage-servicing issues and the development of new national mortgage-servicing standards. This statement focuses on the results of the horizontal review of 14 large mortgage servicers conducted by the Federal Reserve Board and the other banking regulators in 2010, the enforcement orders that the Federal Reserve, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation issued as a result of those reviews, and the steps the Federal Reserve has taken in leading an interagency effort to develop new uniform national servicing and foreclosure-processing standards.

Results of the Horizontal Servicer Review

The Federal Reserve System, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation (the "agencies") completed in the fourth quarter of 2010 a review of mortgage servicing and foreclosure processing at 14 federally regulated mortgage servicers.[1] The review found critical weaknesses in foreclosure-governance practices, foreclosure-documentation processes, and oversight and monitoring of third-party law firms and other vendors. Moreover, on-site examiners found deficiencies in loan files, inadequate staffing and training, as well as an undue emphasis on quantitative production

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1 The 14 servicers were selected based on the high concentration of their mortgage-servicing and foreclosure processing activities.

and timeliness instead of quality and adequate workload monitoring. The reviews revealed a need for substantial improvement in controls. The policies and procedures at many of the servicers were weak and needed expansion to provide effective monitoring of servicing activities. The reviews revealed heavy reliance on outsourcing arrangements with third party vendors without adequate oversight of these arrangements. Furthermore, internal audits and self assessments failed to identify specific weaknesses and process gaps. These weaknesses involved unsafe and unsound practices and violations of federal and state laws and demonstrated a pattern of misconduct and negligence. The *Interagency Review of Foreclosure Policies and Practices* -- issued in April 2011 by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision -- provides a summary of the review findings and is attached.

Enforcement Actions

Based on the findings from the review, the agencies issued enforcement actions by consent against the 14 mortgage servicers in April 2011 to address the significant deficiencies in mortgage-servicing and foreclosure practices.[2] The Federal Reserve also indicated, at the time the enforcement actions were issued, that it believes monetary sanctions in these cases are appropriate and plans to announce monetary penalties. The Federal Reserve and the other agencies noted that the deficiencies and weaknesses required immediate attention to ensure that customers are treated fairly and the servicers' processes are safe and sound as well as fully compliant with all applicable laws. The orders require the servicers, among other things, to:

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[2] The Federal Reserve issued enforcement actions against the four mortgage servicers it supervises. In addition to the actions against the servicers, the Federal Reserve and the Office of the Thrift Supervision have issued formal enforcement actions against parent holding companies of servicers subject to the Agencies' enforcement actions to require that they enhance on a consolidated basis their oversight of mortgage-servicing activities, including compliance, risk management, and audit.

- Establish a compliance program to ensure mortgage-servicing and foreclosure operations, including loss mitigation and loan modification, comply with applicable legal requirements and supervisory guidance, and assure appropriate policies and procedures, staffing, training, oversight, and quality control of those processes.
- Retain an independent firm to conduct a review of residential foreclosure actions that were pending at any time from January 1, 2009, through December 31, 2010, to determine any financial injury to borrowers caused by errors, misrepresentations, or other deficiencies identified in the review, and to remediate, as appropriate, those deficiencies.
- Ensure the following: that effective coordination of communication with borrowers is observed in relation to foreclosure, loss-mitigation, and loan-modification activities; that communications are timely and appropriate and designed to avoid borrower confusion; that continuity is maintained in the handling of borrower cases during the loan-modification and foreclosure processes; that reasonable and good-faith efforts, consistent with applicable law and contracts, are observed where appropriate, in engaging in loss mitigation and foreclosure prevention for delinquent loans ; and that decisions concerning loss mitigation or loan modifications will be made and communicated in a timely manner.
- Establish policies and procedures governing outsourcing of foreclosure or related functions to ensure appropriate oversight and that activities comply with all applicable legal requirements, supervisory guidance, and the servicer's policies and procedures, including the appropriate selection and oversight of all third-party service providers, including external legal counsel.

- Improve management information systems for foreclosure, loss-mitigation, and loan-modification activities to ensure timely delivery of complete and accurate information to facilitate effective decision making.
- Retain an independent firm to conduct a written, comprehensive assessment of risks in servicing operations, particularly in the areas of foreclosure, loss-mitigation, and the administration and disposition of other real estate owned, including but not limited to operational, compliance, transaction, legal, and reputational risks.
- Make significant revisions to foreclosure procedures that involve dual-tracking, which occurs when servicers continue to pursue foreclosure during the loan modification process. More specifically, the servicers must ensure that foreclosures are not pursued once a mortgage has been approved for modification (whether trial or permanent), unless two or more repayments under the modified loan are not made. This means that these servicers will no longer be permitted to pursue foreclosures when borrowers are complying with the terms of their modifications.

The Federal Reserve is monitoring, on an ongoing basis, the corrective measures that are being taken by the servicers and bank holding companies it supervises, as required by the enforcement actions. More specifically, at this time, the Federal Reserve is assessing the plans, programs, policies, procedures, and engagement letters that the servicers and bank holding companies must submit to implement those corrective measures and fully address the identified deficiencies, each of which must be approved by the Federal Reserve. The Federal Reserve will closely monitor and review the servicers' and bank holding companies' progress to ensure that the plans are implemented as approved and to ensure that the changes are effective. Each servicer is also required to submit quarterly reports to the Federal Reserve detailing the measures it has taken to comply with the action and the results of those measures. The Federal Reserve will take appropriate supervisory action to address any inadequacies or violations of the enforcement actions.

Although these enforcement actions do not expressly mandate loan modifications, the actions' "single-point-of-contact" requirements are designed to improve communications between the mortgage servicers and consumers in loss-mitigation and foreclosure. These requirements should also lead to less confusion among consumers about what they need to do to keep their homes. In addition, the improvements required by the enforcement actions will strengthen the integrity, fairness and legal compliance of the foreclosure process. Finally, the improvements that mortgage servicers make in their overall operations are expected to reduce legal uncertainty about foreclosures. All of these actions should lead to a more efficient loan modification process.

It was necessary for the Federal Reserve Board and the other agencies to ensure that the serious deficiencies uncovered during the agencies' horizontal reviews were corrected promptly. This required immediate action by the agencies and is separate from the settlement discussions between the state Attorneys General and the largest servicers related to their servicing practices. The Department of Justice ("DOJ") is coordinating with the state Attorneys General toward a comprehensive solution to problems uncovered in the servicing of mortgage loans. The Federal Reserve Board is in close contact with the DOJ regarding those discussions.

It is important to emphasize that the enforcement actions taken by the Federal Reserve Board complement the actions under consideration by the state Attorneys General and they do not preempt or preclude action by other federal or state agencies. Indeed, the enforcement actions specifically state, for example: "The provisions of this Order shall not bar, estop, or otherwise prevent the Board of Governors, the FDIC, the Reserve Bank, or any other federal or state agency from taking any further or other action ..."

National Servicing Standards

The enforcement actions taken by the Federal Reserve and the other agencies apply only to the servicers subject to them. Another initiative, which is ongoing, is the inter-agency development of uniform national mortgage-servicing and foreclosure-processing standards that would apply to all servicers. The Federal Reserve Board, Treasury, U.S. Department of Housing and Urban Development, Federal Housing Administration, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Office of Thrift Supervision and Federal Housing Finance Agency are collaborating to develop a set of uniform servicing standards for banks and other mortgage servicing organizations.[3] These standards are expected to address the proper handling of both performing and non-performing loans, including loss-mitigation procedures and foreclosure processing, and should lead to improved customer treatment and better transparency and oversight of mortgage servicers' processes. The intent of the initiative is to hold servicers to the same standards regardless of their regulator and regardless of whether the loans being serviced are held on the originator's books, have been sold, or have been securitized. By having a common set of standards for the mortgage-servicing industry, the financial regulatory agencies will support the adoption of servicing practices that promote the best interests of borrowers and the broader housing market. This initiative will also draw upon the findings of the horizontal review to systematically address the weaknesses that the review

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[3] Representatives of the Consumer Financial Protection Bureau also are participating as observers, with the expectation that once the Bureau becomes operational they will be a full participant.

uncovered and the enforcement actions and their related action plans to guide proposals for specific standards.

Conclusion

The Federal Reserve has taken a number of approaches towards mitigating the harm to consumers and to markets caused by problems in mortgage servicing and foreclosure processing. We will continue to monitor and assess the corrective actions taken by the servicers and the holding companies, as required by the enforcement actions, and take further action when necessary to address failures. The Federal Reserve Board's enforcement actions will remain in place until weaknesses and deficiencies have been corrected. Likewise, the Federal Reserve Board will remain in close contact with the DOJ regarding the settlement discussions between the state Attorneys General and the largest servicers. Additionally, the Board supports the development of a uniform set of national mortgage-servicing and foreclosure-processing standards to promote accountability and appropriate practices in dealing with consumers. Thank you for the opportunity to submit this statement on the role of the federal regulators in the ongoing mortgage-servicing issues and the development of uniform national mortgage-servicing standards.

Interagency Review of Foreclosure Policies and Practices

Federal Reserve System
Office of the Comptroller of the Currency
Office of Thrift Supervision

Washington, D.C. • April 2011

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Federal Reserve System
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WASHINGTON, D.C. • APRIL 2011

Contents

Executive Summary

The Federal Reserve System, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS), referred to as the agencies, conducted on-site reviews of foreclosure processing at 14 federally regulated mortgage servicers during the fourth quarter of 2010.[1]

This report provides a summary of the review findings and an overview of the potential impacts associated with instances of foreclosure-processing weaknesses that occurred industrywide. In addition, this report discusses the supervisory response made public simultaneous with the issuance of this report, as well as expectations going forward to address the cited deficiencies. The supervisory measures employed by the agencies' are intended to ensure safe and sound mortgage-servicing and foreclosure-processing business practices are implemented. The report also provides an overview of how national standards for mortgage servicing can help address specific industrywide weaknesses identified during these reviews.

Review Scope and Objectives

The primary objective of each review was to evaluate the adequacy of controls and governance over servicers' foreclosure processes and assess servicers' authority to foreclose. The reviews focused on issues related to foreclosure-processing functions. While the reviews uncovered significant problems in foreclosure processing at the servicers included in the report, examiners reviewed a relatively small number of files from among the volumes of foreclosures processed by the servicers. Therefore, the reviews could not provide a reliable estimate of the number of foreclosures that should not have proceeded. The agencies, therefore, are requiring each servicer to retain an independent firm to conduct a thorough review of foreclosure actions that were pending at any time from January 1, 2009 through December 31, 2010 to, among other things, 1) identify borrowers that have been financially harmed by deficiencies identified in the independent review and 2) provide remediation to those borrowers where appropriate. These independent reviews will be subject to supervisory oversight to ensure that the reviews are comprehensive and the results are reliable.

For the reviews discussed in this report, examiners evaluated each servicer's self-assessments of their foreclosure policies and processes; assessed each servicer's foreclosure operating procedures and controls; interviewed servicer staff involved in the preparation of foreclosure documents; and reviewed, collectively for all servicers, approximately 2,800 borrower foreclosure files that were in various stages of the foreclosure process between January 1, 2009, and December 31, 2010.[2]

Examiners focused on foreclosure policies and procedures; quality control and audits; organizational structure and staffing; and vendor management,

[1] Agencies conducted foreclosure-processing reviews at Ally Bank /GMAC, Aurora Bank, Bank of America, Citibank, EverBank, HSBC, JPMorgan Chase, MetLife, OneWest, PNC, Sovereign Bank, SunTrust, US Bank, and Wells Fargo. The reviews included mortgage-servicing activities conducted by insured banks and thrifts, as well as by several nonbank affiliates of these organizations. The 14 servicers were selected based on the concentration of their mortgage-servicing and foreclosure-processing activities. The agencies typically do not disclose examinations or examination findings regarding particular institutions. In light of the formal enforcement actions entered into by these 14 servicers, which are being made public, the agencies have determined that it is appropriate to identify the servicers (whether a bank or a bank affiliate) that were reviewed. The bank and thrift holding company parents of Ally Bank /GMAC, Bank of America, Citibank, Everbank, HSBC, JPMorgan Chase, MetLife, OneWest, PNC, SunTrust, US Bank, and Wells Fargo also entered into formal enforcement actions.

[2] Foreclosure files at each servicer were selected from the population of in-process and completed foreclosures during 2010. The foreclosure file sample at each servicer included foreclosures from both judicial states and nonjudicial states. Review teams independently selected foreclosure file samples based on pre-established criteria (such as files for which consumer complaints had been raised, or those in geographic areas with high volumes of foreclosures) with the balance of the files selected based on examiner judgment.

including use of third-party vendors such as foreclosure attorneys, Lender Processing Services (LPS) and other default-service providers, and MERSCORP and its wholly owned subsidiary, Mortgage Electronic Registration Systems, Inc. (MERS). Based on their reviews of the limited number of foreclosure-file samples, examiners also assessed the accuracy of foreclosure-related documentation, including note endorsements and the assignments of mortgages and deeds of trust, and loan document control.[3] With respect to those files, examiners also assessed whether fees charged in connection with the foreclosures exceeded the amounts reflected in the servicers' internal records. In addition, the Federal Reserve and the OCC solicited views from consumer groups to help detect problems at specific servicers, and the Federal Reserve expanded the file sample to include borrowers who were delinquent, but not yet in foreclosure.

The file reviews did not include a complete analysis of the payment history of each loan prior to foreclosure or potential mortgage-servicing issues outside of the foreclosure process. Accordingly, examiners may not have uncovered cases of misapplied payments or unreasonable fees, particularly when these actions occurred prior to the default that led to the foreclosure action. The foreclosure-file reviews also may not have uncovered certain facts related to the processing of a foreclosure that would lead an examiner to conclude that a foreclosure otherwise should not have proceeded, such as undocumented communications between a servicer employee and the borrower in which the employee told the borrower he or she had to be delinquent on the loan to qualify for a modification. In addition, the reviews did not focus on loan-modification processes, but when reviewing individual foreclosure files, examiners checked for evidence that servicers were in contact with borrowers and had considered alternative loss-mitigation efforts, including loan modifications.

To ensure consistency in the reviews, the agencies used standardized work programs to guide the assessment and to document findings pertaining to each servicer's corporate governance process and the individual foreclosure-file reviews. The work programs were organized into the following categories:

- **Policies and procedures**. Examiners reviewed the servicers' policies and procedures to see if they provided adequate controls over the foreclosure process and whether those policies and procedures were sufficient for compliance with applicable laws and regulations.
- **Organizational structure and staffing**. Examiners reviewed the functional unit(s) responsible for foreclosure processes, including their staffing levels, their staff's qualifications, and their training programs.
- **Management of third-party service providers**. Examiners reviewed the servicers' oversight of key third parties used throughout the foreclosure process, with a focus on foreclosure attorneys, MERS, and default-service providers such as LPS.
- **Quality control and internal audits**. Examiners assessed quality-control processes in foreclosures. Examiners also reviewed internal and external audit reports, including government-sponsored enterprise (GSE) and investor audits and reviews of foreclosure activities as well as servicers' self-assessments.
- **Compliance with applicable laws**. Examiners checked the adequacy of the governance, audits, and controls that servicers had in place to ensure compliance with applicable laws.
- **Loss mitigation**. Examiners determined if servicers were in direct communication with borrowers and whether loss-mitigation actions, including loan modifications, were considered as alternatives to foreclosure.
- **Critical documents**. Examiners evaluated servicers' control over critical documents in the foreclosure process, including the safeguarding of original loan documentation. Examiners also determined whether critical foreclosure documents were in the foreclosure files that they reviewed, and whether notes were endorsed and mortgages assigned.
- **Risk management**. Examiners assessed whether servicers appropriately identified financial, reputational, and legal risks and whether these risks were communicated to the board of directors and senior management of the servicer.

Summary of Review Findings

The reviews found critical weaknesses in servicers' foreclosure governance processes, foreclosure document preparation processes, and oversight and monitoring of third-party vendors, including foreclosure attorneys. While it is important to note that findings

[3] For purposes of this report, default management services generally include administrative support and services provided to the servicers by third-party vendors to manage and perform the tasks associated with foreclosures.

varied across institutions, the weaknesses at each servicer, individually or collectively, resulted in unsafe and unsound practices and violations of applicable federal and state law and requirements.[4] The results elevated the agencies' concern that widespread risks may be presented—to consumers, communities, various market participants, and the overall mortgage market. The servicers included in this review represent more than two-thirds of the servicing market. Thus, the agencies consider problems cited within this report to have widespread consequences for the national housing market and borrowers.

Based on the deficiencies identified in these reviews and the risks of additional issues as a result of weak controls and processes, the agencies at this time are taking formal enforcement actions against each of the 14 servicers subject to this review to address those weaknesses and risks. The enforcement actions require each servicer, among other things, to conduct a more complete review of certain aspects of foreclosure actions that occurred between January 1, 2009, and December 31, 2010. The specific supervisory responses are summarized in Part 3 of this report.

The loan-file reviews showed that borrowers subject to foreclosure in the reviewed files were seriously delinquent on their loans. As previously stated, the reviews conducted by the agencies should not be viewed as an analysis of the entire lifecycle of the borrowers' loans or potential mortgage-servicing issues outside of the foreclosure process. The reviews also showed that servicers possessed original notes and mortgages and, therefore, had sufficient documentation available to demonstrate authority to foreclose. Further, examiners found evidence that servicers generally attempted to contact distressed borrowers prior to initiating the foreclosure process to pursue loss-mitigation alternatives, including loan modifications. However, examiners did note cases in which foreclosures should not have proceeded due to an intervening event or condition, such as the borrower (a) was covered by the Servicemembers Civil Relief Act, (b) filed for bankruptcy shortly before the foreclosure action, or (c) qualified for or was paying in accordance with a trial modification.[5]

The interagency reviews identified significant weaknesses in several areas.

- **Foreclosure process governance.** Foreclosure governance processes of the servicers were underdeveloped and insufficient to manage and control operational, compliance, legal, and reputational risk associated with an increasing volume of foreclosures. Weaknesses included:
  - inadequate policies, procedures, and independent control infrastructure covering all aspects of the foreclosure process;
  - inadequate monitoring and controls to oversee foreclosure activities conducted on behalf of servicers by external law firms or other third-party vendors;
  - lack of sufficient audit trails to show how information set out in the affidavits (amount of indebtedness, fees, penalties, etc.) was linked to the servicers' internal records at the time the affidavits were executed;
  - inadequate quality control and audit reviews to ensure compliance with legal requirements, policies and procedures, as well as the maintenance of sound operating environments; and
  - inadequate identification of financial, reputational, and legal risks, and absence of internal communication about those risks among boards of directors and senior management.
- **Organizational structure and availability of staffing.** Examiners found inadequate organization and staffing of foreclosure units to address the increased volumes of foreclosures.
- **Affidavit and notarization practices.** Individuals who signed foreclosure affidavits often did not personally check the documents for accuracy or possess the level of knowledge of the information that they attested to in those affidavits. In addition, some foreclosure documents indicated they were executed under oath, when no oath was administered. Examiners also found that the majority of the servicers had improper notary practices which failed to conform to state legal requirements. These determinations were based primarily on servicers' self-assessments of their foreclosure processes and examiners' interviews of servicer staff involved in the preparation of foreclosure documents.
- **Documentation practices.** Examiners found some—but not widespread—errors between actual fees charged and what the servicers' internal records indicated, with servicers undercharging fees as frequently as overcharging them. The dollar amount

[4] This report captures only the significant issues found across the servicers reviewed, not necessarily findings at each servicer.

[5] Servicemembers Civil Relief Act, 50 USC App. sections. 501–596, Public Law 108-189.

of overcharged fees as compared with the servicers' internal records was generally small.

- **Third-party vendor management.** Examiners generally found adequate evidence of physical control and possession of original notes and mortgages. Examiners also found, with limited exceptions, that notes appeared to be properly endorsed and mortgages and deeds of trust appeared properly assigned.[6] The review did find that, in some cases, the third-party law firms hired by the servicers were nonetheless filing mortgage foreclosure complaints or lost-note affidavits even though proper documentation existed.
- **Quality control (QC) and audit.** Examiners found weaknesses in quality control and internal auditing procedures at all servicers included in the review.

Summary of Supervisory Response

The agencies recognize that a number of supervisory actions and industry reforms are required to address these weaknesses in a way that will hold servicers accountable for establishing necessary governance and controls. Measures that the servicers are being required to implement are designed to ensure compliance with applicable laws, promote foreclosure processing in a safe and sound manner, and establish responsible business practices that provide accountability and appropriate treatment to borrowers.

At this time, the agencies are taking formal enforcement action against each of the 14 servicers and parent bank holding companies because the deficiencies and weaknesses identified during the reviews represent unsafe or unsound practices and violations of applicable law. The foreclosure-file reviews showed that borrowers in the sampled pool were seriously delinquent. The reviews also showed that the appropriate party brought the foreclosure action. However, a limited number of mortgages should not have proceeded to foreclosure because of an intervening event or condition. Nevertheless, the weaknesses in servicers' foreclosure processes, as confirmed by the reviews, present significant risk to the safety and soundness of mortgage activities. The failures and deficiencies identified as part of the reviews must be remedied swiftly and comprehensively.

The agencies will continue to assess and monitor corrective actions and will address servicers' failures to correct identified deficiencies where necessary.

Going forward, servicers must develop and demonstrate effective risk management of servicing operations to prevent a recurrence of deficiencies cited in this report. The agencies are currently engaged in an effort to establish national mortgage-servicing standards to promote the safe and sound operation of mortgage-servicing and foreclosure processing, including standards for accountability and responsiveness to borrower concerns. Such an effort will include engaging the Government Sponsored Enterprises, private investors, consumer groups, the servicing industry, and other regulators. Part 4 of this report provides a general overview of the core principles that should be included in future national mortgage-servicing standards.

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[6] The agencies expect federally regulated servicers to have the necessary policies and procedures in place to ensure that notes are properly endorsed and mortgages are properly assigned, so that ownership can be determined at the time of foreclosure. Where federally regulated servicers serve as document custodians for themselves or other investors, the agencies require controls and tracking systems to properly safeguard the physical security and maintenance of critical loan documents.

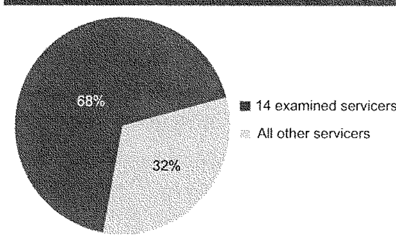
Part 1: Background and Risks Associated with Weak Foreclosure Process and Controls

Mortgage servicing plays a central role in the management of mortgage loans from origination to final disposition. The mortgage servicer is the intermediary between borrowers and their lenders. When the borrower is paying as agreed, the servicer's duties are ministerial: collecting payments, distributing payments to investors, managing cash and administering funds in escrow, and reporting to investors. When a loan is in default, the demands on the servicer necessarily expand, requiring additional resources and much more sophisticated risk management. A necessary consequence of the growth in foreclosures since 2007 is increased demands on servicers' foreclosure processes.

The residential mortgage-servicing market is highly concentrated among a few servicers. The five largest mortgage servicers by activity volume—included among the 14 servicers subject to the reviews addressed in this report—account for 60 percent of the industry's total servicing volume.[7] The 14 servicers included in the interagency review collectively represent more than two-thirds of the servicing industry (see **figure 1**), or nearly 36.7 million mortgages.[8]

At the end of the fourth quarter of 2010, nearly 54 million first-lien mortgage loans were outstanding, 2.4 million of which were at some point in the foreclosure process. Additionally, two million mortgages were 90 or more days past due and at an elevated risk of foreclosure. New foreclosures are on pace to approach 2.5 million by the end of 2011. In light of the number of foreclosures and continued weakness in overall mortgage performance, the agencies are concerned that the deficiencies in foreclosure processing observed among these major servicers may have widespread consequences for the housing market and borrowers.

Figure 1. Concentration of the mortgage-servicing industry



Source: Federal Reserve staff estimates of the concentration of servicing volume, based on data from Inside Mortgage Finance.

Impact on Borrowers

Weaknesses in foreclosure processes and controls present the risk of foreclosing with inaccurate documentation, or foreclosing when another intervening circumstance should intercede. Even if a foreclosure action can be completed properly, deficiencies can result (and have resulted) in violations of state foreclosure laws designed to protect consumers. Such weaknesses may also result in inaccurate fees and charges assessed against the borrower or property, which may make it more difficult for borrowers to bring their loans current. In addition, borrowers can find their loss-mitigation options curtailed because of dual-track processes that result in foreclosures even when a borrower has been approved for a loan modification. The risks presented by weaknesses in foreclosure processes are more acute when those processes are aimed at speed and quantity instead of quality and accuracy.

[7] The five largest mortgage servicers in order are Bank of America, Wells Fargo, JPMorgan Chase, Citibank, and Ally Bank/GMAC.

[8] Federal Reserve staff estimates 54 million first-lien mortgages outstanding as of December 31, 2010.

Impact on the Industry and Investors

Weaknesses in foreclosure processes pose a variety of risks to the financial services industry and investors. These risks extend beyond the financial cost of remedying procedural errors and re-filing affidavits and other foreclosure documents. Servicers may also bear legal costs related to disputes over note ownership or authority to foreclose, and to allegations of procedural violations through the use of inaccurate affidavits and improper notarizations. Servicers may be subject to claims by investors as a result of delays or other damages caused by the weaknesses. Furthermore, concerns about the prevalence of irregularities in the documentation of ownership may cause uncertainty for investors of securitized mortgages. Servicers and their affiliates also face significant reputational risk with their borrowers, with the court system, and with regulators.

Impact on the Judicial Process

Weaknesses in foreclosure processes have resulted in increased demands on judicial resources to resolve a variety of foreclosure-related matters, including note ownership. In addition, courts rely extensively on affidavits (usually affidavits of indebtedness) submitted by servicers to decide foreclosure actions on a summary basis without requiring in-person testimony.[9] If such affidavits were not properly prepared or executed, courts may lose confidence in the reliability of the affidavits as persuasive evidence filed on behalf of servicers.[10]

Impact on the Mortgage Market and Communities

Weaknesses in foreclosure processes led several servicers to slow, halt, or suspend foreclosure proceedings in late 2010, and, in many cases, re-file foreclosure documents. Delays in foreclosure processing, which averaged 450 days in the fourth quarter of 2010, slow the clearing of excess inventory of foreclosed properties and lead to extended periods of depressed home prices.[11] Such delays also impede the efficient disposition of foreclosed homes and the clearing of seriously delinquent mortgages, particularly in geographic regions with greater concentrations of vacant and abandoned properties. This outcome acts as an impediment for communities working to stabilize local neighborhoods and housing markets.[12]

Moreover, local property values may be adversely affected if foreclosed homes remain vacant for extended periods, particularly if such homes are not properly maintained.[13] Widely publicized weaknesses in foreclosure processes also adversely affect home buyer and investor confidence. Assuring robust and credible remedial programs for mortgage servicers so that foreclosure processes can operate and markets can clear without impediments or interventions contributes to attaining a stable national housing market.

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[9] The basic affidavit of indebtedness typically sets forth the name of the party that owns the loan, the default status, and the amounts due for principal, interest, penalties (such as late charges), and fees. This affidavit is frequently the principal basis upon which a court is permitted to order a foreclosure without requiring in-person testimony. Similar documentation may be required in bankruptcy proceedings.

[10] Mortgage foreclosures occur under either a judicial or a nonjudicial process. Judicial foreclosures are court-supervised and require the lender to bring a court action to foreclose. nonjudicial foreclosures (also known as "power of sale") involve little or no court oversight and generally are governed by state statutes. Even foreclosures that are instituted outside the judicial process can be challenged in court, however, and then become subject to court actions.

[11] See *Lender Processing Services Applied Analytics* (December 2010, www.lpsvcs.com/RiskMgmt). Current time frames to move a property to foreclosure sale have increased from an average of 250 days in first quarter 2008 to 450 days by fourth quarter 2010.

[12] Industry data show approximately four million properties currently listed that have been foreclosed in the past few years. See Mortgage Bankers Association, *National Delinquency Survey*, (November 18, 2010, www.mbaa.org/NewsandMedia/PressCenter/74733.htm).

[13] Campbell, John Y., Stefano Giglio and Parag Pathak (July 2010) *Forced Sales and House PricesManuscript*, Harvard University Department of Economics (kuznets.fas.harvard.edu/~campbell/papers/forcedsales072410.pdf).

Part 2: Review Findings

The reviews found critical weaknesses in foreclosure governance processes, foreclosure document preparation processes, and oversight and monitoring of third-party law firms and other vendors. These weaknesses involve unsafe and unsound practices and violations of applicable federal and state laws and requirements, and they have had an adverse effect on the functioning of the mortgage markets. By emphasizing speed and cost efficiency over quality and accuracy, examined servicers fostered an operational environment contrary to safe and sound banking practices.

In connection with the reviews of sampled files and assessments of servicers' custodial activities, examiners found that borrowers whose files were reviewed were seriously delinquent on their mortgage payments at the time of foreclosure and that servicers generally had sufficient documentation available to demonstrate authority to foreclose on those borrowers' mortgages.[14] Nevertheless, examiners noted instances where documentation in the foreclosure file alone may not have been sufficient to prove ownership of the note at the time the foreclosure action commenced without reference to additional information. When additional information was requested and provided to examiners, it generally was sufficient to determine ownership.

In addition, review of the foreclosure files showed that servicers were in contact with the delinquent borrowers and had considered loss-mitigation alternatives, including loan modifications. Examiners also noted a small number of foreclosure sales, however, that should not have proceeded because of an intervening event or condition, such as the borrower: (a) was covered by the Servicemembers Civil Relief Act, (b) filed bankruptcy shortly before the foreclosure action, or (c) was approved for a trial modification.

A summary of the major findings identified during the reviews is set forth below.

Foreclosure Process Governance

Examiners found governance at each examined servicer in need of substantial improvement, and often cited the absence of sound controls and ineffective management of foreclosure processes. Foreclosure policies and procedures at many of the servicers were either weak or needed substantial expansion to provide effective guidance, control, and ongoing monitoring. As noted above, examiners concluded that the majority of servicers reviewed had inadequate affidavit and notary-signing processes that did not ensure proper attestation (or verification) of the underlying documents.

Examiners found that most servicers had inadequate staffing levels and training programs throughout the foreclosure-processing function and that a large percentage of the staff lacked sufficient training in their positions. The reviews also revealed that all of the servicers relied heavily on outsourcing arrangements with outside counsel and other third-party vendors to carry out foreclosure processes without adequate oversight of those arrangements. Some servicers failed to enter into contracts with the foreclosure law firms performing critical steps in the foreclosure process, including affidavit- and notary-preparation and signing processes. Audit and quality-assurance controls and self-assessment reviews at all of the examined servicers lacked comprehensiveness and failed to identify specific weaknesses and process gaps. Details on these areas of weakness are included below.

[14] As previously noted, examiners were limited to the documents in the foreclosure files. Those documents may not have disclosed certain facts that might have led examiners to conclude that a foreclosure should not have proceeded, such as misapplication of payments that could have precipitated a foreclosure action or oral communications between the borrower and servicer staff that were not documented in the foreclosure file.

Organizational Structure and Availability of Staffing

At the time of the review, a majority of the servicers had inadequate staffing levels or had recently added staff with limited servicing experience. In most instances, servicers maintained insufficient staff to appropriately review documents for accuracy, and provided inadequate training for affidavit signers, notaries, and quality-control staff. Examiners also noted weak controls, undue emphasis on quantitative production and timelines, and inadequate workload monitoring.

Affidavit and Notarization Practices

Deficiencies in servicers' processes, procedures, controls, and staffing resulted in numerous inaccurate affidavits and other foreclosure-related documents. Examiners found that most servicers had affidavit signing protocols that expedited the processes for signing foreclosure affidavits without ensuring that the individuals who signed the affidavits personally conducted the review or possessed the level of knowledge of the information that they attested to in those affidavits. Examiners confirmed these deficiencies through interviews with individuals who signed documents, as well as through a review of servicers' self-assessments. Examiners also found the majority of the servicers had improper notary practices that failed to conform to state legal requirements. Examiners noted some servicers failed to maintain an accurate list of approved and acceptable notaries that individuals signing documents did not do so in the presence of a notary when required, and that documents often were executed in a manner contrary to the notary's acknowledgement and verification of those documents. In addition, some foreclosure documents indicated they were executed under oath when no oath was administered. Again, examiners confirmed these deficiencies by interviewing notaries and reviewing servicers' self-assessments.

At the examined servicers, anywhere from 100 to more than 25,000 foreclosure actions occurred per month between January 1, 2009, and December 31, 2010, with the quantity depending upon the size of the servicer's operations. It was common to find an insufficient number of staff assigned to review, sign, and notarize affidavits. At some of the servicers, examiners found that insufficient staff—or the lack of specified guidance to staff or external law firms on affidavit completion—contributed to the preparation and filing of inaccurate affidavits. In the sample of foreclosure files reviewed, examiners compared the accuracy of the amounts listed on affidavits of indebtedness to the documentation in the paper foreclosure file or computerized loan servicing systems. Although borrowers whose foreclosure files were reviewed were seriously in default at the time of the foreclosure action, some servicers failed to accurately complete or validate itemized amounts owed by those borrowers. At those servicers, this failure resulted in differences between the figures in the affidavit and the information in the servicing system or paper file. In nearly half of those instances, the differences—which were typically less than $500—were adverse to the borrower. While the error rates varied among the servicers, the percentage of errors at some servicers raises significant concerns regarding those servicers' internal controls governing foreclosure-related documentation.

Documentation Practices

During the foreclosure-file reviews, examiners compared the accuracy of amounts listed on the servicers' affidavits of indebtedness with documentation on file or maintained within the electronic servicing system of record. For most of the servicers, examiners cited the lack of a clear auditable trail in reconciling foreclosure filings to source systems of record. In some cases, examiners directed servicers to further audit foreclosure filings to verify the accuracy of information and compliance with legal requirements. Likewise, in connection with the file review, examiners also determined whether critical foreclosure documents were in the foreclosure files, and whether notes appeared properly endorsed and mortgages appeared properly assigned. Examiners noted instances where documentation in the foreclosure file alone may not have been sufficient to prove authority to foreclose without reference to additional information.[15] When more information was requested and provided, it generally was sufficient to determine authority. With some exceptions, examiners found that notes appeared properly endorsed, and mortgages appeared properly assigned.[16] Examiners also trav-

[15] Servicers frequently maintained custody of original mortgage documents, although in some cases third-party trustees or custodians held original documents. Custodians are entrusted to manage the original documents that establish note ownership, and, when necessary, produce the original documents for a foreclosure action.

[16] Only in rare instances were custodians unable to produce origi-

eled to servicers' document repository locations to assess custodial activities. Examiners found that servicers generally had possession and control over critical loan documents such as the promissory notes and mortgages. The review did find that, in some cases prior to 2010, the third-party law firms hired by the servicers were nonetheless filing lost-note affidavits or mortgage foreclosure complaints in which they claimed that the mortgage note had either been lost or destroyed, even though proper documentation existed.

Third-party Vendor Management

The agencies found that the servicers reviewed generally did not properly structure, carefully conduct, or prudently manage their third-party vendor relationships with outside law firms and other third-party foreclosure services providers. Failure to effectively manage third-party vendors resulted in increased reputational, legal, and financial risks to the servicers.

Arrangements with Outside Law Firms

Servicers typically used third-party law firms to prepare affidavits and other legal documents, to file complaints and other pleadings with courts, and to litigate on their behalf in connection with foreclosure and foreclosure-related bankruptcy proceedings. The servicers reviewed generally showed insufficient guidance, policies, or procedures governing the initial selection, management, or termination of the law firms that handled their foreclosures. Many servicers, rather than conducting their own due diligence, relied on the fact that certain firms had been designated as approved or accepted by investors. Servicers often did not govern their relationships with these law firms by formal contracts. Instead, servicers frequently relied on informal engagements with law firms, at times relying on investors' business relationships with the law firms or the law firms' contractual relationships with default management service providers.

Inadequate Oversight

Servicers also did not provide adequate oversight of third-party vendor law firms, including monitoring for compliance with the servicers' standards. Several servicers exempted third-party law firms from the servicers' vendor management programs or did not identify them as third-party vendors subject to those programs. In some cases, servicers assumed that investors performed such oversight, in which case oversight was limited to ensuring that the law firms were on the investors' lists of approved or accepted providers. Where monitoring of law firms was conducted, it was often limited to things such as responsiveness and timeliness, checking for liability insurance, or determining if any power of attorney given to the firm remained valid rather than assessing the accuracy and adequacy of legal documents or compliance with state law or designated fee schedules.

Document Retention Weaknesses

Examiners also found that the servicers did not always retain originals or copies of the documents maintained by the third-party law firms that conducted their foreclosures. Instead, the servicers relied on the firms to maintain those documents. The absence of central and well-organized foreclosure files by the servicers and the consequent need for the examiners to collect foreclosure documentation derived from numerous sources made it difficult at times for examiners to conduct full foreclosure-file reviews while on-site.

Inadequate guidance, policies, procedures, and contracts

In addition, examiners generally found an absence of formal guidance, policies, or procedures governing the selection, ongoing management, and termination of law firms used to handle foreclosures. This deficiency resulted in a lack of clarity regarding roles, responsibilities, and performance parameters. Examiners also observed an absence of written contracts between certain servicers and law firms, which left those servicers with no contractual recourse for liability against the firms for performance issues. These deficiencies, coupled with the overall lack of adequate oversight, contributed to instances in which servicers and law firms failed to identify problems with the firms' foreclosure practices, thereby exposing the servicers to a variety of significant risks.

Those problems include instances in which law firms signed documents on behalf of servicers without having the authority to do so, or they changed the format and content of affidavits without the knowledge of the servicers. These defects could, depending upon the circumstances, raise concerns regarding the legality and propriety of the foreclosure even if the ser-

nal loan documentation, and in those instances the servicers generally were able to provide adequate explanations, including that copies in the possession of the custodian were acceptable under applicable law.

vicer had sufficient documentation available to demonstrate authority to foreclose.

Arrangements with Default Management Service Providers (DMSPs)

In connection with the on-site reviews of servicers, the agencies also conducted an on-site review of Lender Processing Services, Inc. (LPS), which provides significant services to support mortgage-servicing and foreclosure processing across the industry. The review of LPS involved a number of issues that are similar to those raised in the reviews of the servicers, and the LPS review covered issues that are unique to the operations, structure and corporate governance of LPS. During the review of LPS, the agencies found deficient practices related primarily to the document execution services that LPS, through its DocX, LLC, and LPS Default Solutions, Inc. subsidiaries had provided to servicers in connection with foreclosures. To address these issues, the agencies are taking formal enforcement action against LPS under section 7(d) of the Bank Service Company Act, 12 USC § 1867(d), and section 8(b) of the Federal Deposit Insurance Act, 12 USC § 1818(b).

Inadequate Contracts

During the review of servicers, examiners assessed servicers' relationships with third-party vendor DMSPs, focusing primarily on DMSPs that supported the execution of foreclosure-related documents, such as affidavits of indebtedness, lost-note affidavits, and assignments of mortgages.[17] Examiners found that contracts between the servicers and DMSPs generally were inadequate, often omitting significant matters such as service-level agreements. Contracts did not provide for an appropriate level of oversight of third-party vendor law firms in situations where the servicers relied on the DMSPs to conduct such oversight.

Inadequate Oversight

Examiners also observed that servicers generally demonstrated an overall lack of adequate oversight of DMSPs. At times, the servicers failed to identify DMSPs as vendors subject to the servicers' vendor management programs and demonstrated an inability to provide the examiners with sufficient evidence of due diligence. Examiners found no evidence that servicers conducted audits of the document execution operations of their DMSPs.

[17] Not all of the servicers engaged the services of third-party vendor DMSPs to perform document execution services.

The lack of sufficient oversight of DMSPs, coupled with the contractual deficiencies, led to instances in which employees of those DMSPs signed foreclosure affidavits without personally conducting the review or possessing the level of knowledge of information that they attested to in those affidavits. Employees of DMSPs, like the employees of the servicers themselves, executed documents in a manner contrary to the notary's acknowledgement and verification of those documents. In addition, in limited instances, employees of DMSPs signed foreclosure-related documents on behalf of servicers without proper authority. Because some of the servicers relied on DMSPs to oversee their third-party vendor law firms, the contractual deficiencies and lack of oversight of DMSPs contributed to the weaknesses identified above regarding the oversight of third-party vendor law firms.

Arrangements with Mortgage Electronic Registration Systems, Inc.

In connection with the on-site reviews of servicers, the agencies, together with the Federal Housing Finance Agency (FHFA), also conducted an on-site review of MERSCORP and its wholly owned subsidiary, Mortgage Electronic Registration Systems, Inc. (collectively, MERS), which, as detailed below, provides significant services to support mortgage-servicing and foreclosure processing across the industry. The review of MERS involved a number of issues that are similar to those raised in the reviews of the servicers, and the MERS review covered issues that are unique to the operations, structure and corporate governance of MERS. During the review of MERS, the agencies and FHFA found significant weaknesses in, among other things, oversight, management supervision and corporate governance. To address these issues, the agencies, together with FHFA, are taking formal enforcement action against MERS under section 7(d) of the Bank Service Company Act, 12 USC § 1867(d), and section 8(b) of the Federal Deposit Insurance Act, 12 USC § 1818(b).

MERS streamlines the mortgage recording and assignment process in two ways. First, it operates a centralized computer database or registry of mortgages that tracks the servicing rights and the beneficial ownership of the mortgage note. Each mortgage registered in the database is assigned a Mortgage Identification Number (MIN). Second, MERS can be designated by a member (and its subsequent assignees) to serve in a nominee capacity as the mortgagee of record in public land records. Designating

MERS as the mortgagee is intended to eliminate the need to prepare and record successive assignments of mortgages each time ownership of a mortgage is transferred. Rather, changes in beneficial ownership of the mortgage note (and servicing rights) are tracked in the MERS registry using the MIN.[18] All of the examined servicers had relationships with MERS.

Inadequate Oversight

Servicers exercised varying levels of oversight of the MERS relationship, but none to a sufficient degree. Several of the servicers did not include MERS in their vendor management programs. In these instances, the servicers failed to conduct appropriate due diligence assessments and failed to monitor, evaluate, and appropriately manage the MERS contractual relationship. Deficiencies included failure to assess the internal control processes at MERS, failure to ensure the accuracy of servicing transfers, and failure to ensure that servicers' records matched MERS' records.

Inadequate Quality Control

Examiners also determined that servicers' quality-control processes pertaining to MERS were insufficient. In some cases, servicers lacked any quality-assurance processes and relied instead on the infrequent and limited audits that MERS periodically conducted. Other deficiencies included the failure to conduct audit reviews to independently verify the adequacy of and adherence to quality-assurance processes by MERS, and the need for more frequent and complete reconciliation between the servicers' systems and the MERS registry. Several servicers did not include MERS activities in the scope of their audit coverage.

Ineffective Quality Control (QC) and Audit

Examiners found weaknesses in quality-control procedures at all servicers, which resulted in servicers not performing one or more of the following functions at a satisfactory level:

- ensuring accurate foreclosure documentation, including documentation pertaining to the fees assessed;
- incorporating mortgage-servicing activities into the servicers' loan-level monitoring, testing, and validation programs;
- evaluating and testing compliance with applicable laws and regulations, court orders, pooling and servicing agreements, and similar contractual arrangements; and
- ensuring proper controls to prevent foreclosures when intervening events or conditions occur that warrant stopping the foreclosure process (e.g., bankruptcy proceedings, applicability of the Servicemembers Civil Relief Act, or adherence to a trial or permanent loan modification program).

Examiners also found weaknesses in internal auditing procedures at all the servicers included in the review. When performed, the few internal audits conducted by servicers failed to identify fundamental control issues that led to the foreclosure process breakdowns. Failures to perform internal audits effectively resulted in servicers' inability to identify, address, and internally communicate foreclosure-processing risks. The failures to identify and communicate these risks resulted in servicers not strengthening the quality of risk-management processes to a level consistent with the nature, increasing size, and complexity of the servicer's foreclosure activities. Moreover, failure to conduct comprehensive audits to identify weaknesses in foreclosure processes resulted in servicers not taking sufficient corrective action to strengthen policy and procedural gaps, increase staffing levels, and improve training in response to sharply rising foreclosure volumes prior to the agencies' foreclosure reviews. The failure to identify the risks associated with foreclosure processing also resulted in servicers not taking action to improve foreclosure documentation-related processes ranging from custody and control of documents to proper notarization processes, or to enhance oversight of third parties managing foreclosure activities on their behalf.

[18] While MERS maintains a registry of the beneficial ownership of the mortgage note, this registry is not a system of legal record. The ownership of the note is determined by the Uniform Commercial Code, and, if a change in ownership of a note is not recorded in MERS or is recorded incorrectly, the transfer is still valid.

Part 3: Supervisory Response

At this time, the agencies are taking formal enforcement actions against each of the 14 servicers under the authority of section 8(b) of the Federal Deposit Insurance Act, 12 USC § 1818(b). The deficiencies and weaknesses identified by examiners during their reviews involved unsafe or unsound practices and violations of law, which have had an adverse impact on the functioning of the mortgage markets. Furthermore, the mortgage servicers' deficient foreclosure processes confirmed during the reviews have compromised the public trust and confidence in mortgage servicing and have consequences for the housing market and borrowers. The formal enforcement actions will require servicers, among other things, to:

- **Compliance program:** Establish a compliance program to ensure mortgage-servicing and foreclosure operations, including loss mitigation and loan modification, comply with all applicable legal requirements and supervisory guidance, and assure appropriate policies and procedures, staffing, training, oversight, and quality control of those processes.
- **Foreclosure review:** Retain an independent firm to conduct a review of residential foreclosure actions that were pending at any time from January 1, 2009, through December 31, 2010, to determine any financial injury to borrowers caused by errors, misrepresentations, or other deficiencies identified in the review, and to remediate, as appropriate, those deficiencies.
- **Dedicated resources for communicating with borrowers/single point of contact:** Ensure the following: effective coordination of communication with borrowers related to foreclosure, loss mitigation, and loan modification activities; assurance that communications are timely and appropriate and designed to avoid borrower confusion, continuity in the handling of borrower cases during the loan modification and foreclosure processes; reasonable and good faith efforts, consistent with applicable law and contracts, to engage in loss mitigation and foreclosure prevention for delinquent loans where appropriate; and assurances that decisions concerning loss mitigation or loan modifications will be made and communicated in a timely manner.
- **Third-party management:** Establish policies and procedures for outsourcing foreclosure or related functions to ensure appropriate oversight and that activities comply with all applicable legal requirements, supervisory guidance and the servicer's policies and procedures, including the appropriate selection and oversight of all third-party service providers, including external legal counsel, DMSPs, and MERS.
- **Management information systems:** Improve management information systems for foreclosure, loss mitigation, and loan modification activities that ensure timely delivery of complete and accurate information to facilitate effective decision making.
- **Risk assessment:** Retain an independent firm to conduct a written, comprehensive assessment of risks in servicing operations, particularly in the areas of foreclosure, loss mitigation, and the administration and disposition of other real estate owned, including but not limited to operational, compliance, transaction, legal, and reputational risks.

In addition to the actions against the servicers, the Federal Reserve and the OTS have issued formal enforcement actions against the parent holding companies to require that they enhance on a consolidated basis their oversight of mortgage-servicing activities, including compliance, risk management, and audit.

The agencies will monitor and assess, on an ongoing basis, the corrective actions taken by the servicers and holding companies that are required by the enforcement actions and take further action, when necessary, to address failures. Enforcement actions and more frequent monitoring will remain in place at each servicer until that servicer has demonstrated that its weaknesses and deficiencies have been corrected, including that adequate policies, procedures, and controls are in place. The agencies will continue to explore ways to improve their supervisory frameworks to identify more promptly and effectively the potential risks in mortgage-servicing and other banking operations.

Part 4: Industry Reforms

Financial regulatory agencies are developing standards within their authority to improve the transparency, oversight, and regulation of mortgage-servicing and foreclosure processing and to set additional thresholds for responsible management and operation of mortgage-servicing activities. Moreover, a uniform set of national mortgage-servicing and foreclosure-processing standards would help promote accountability and appropriateness in dealing with consumers and strengthen the housing finance market.

Industry reforms that could improve the oversight and regulation of mortgage-servicing and foreclosure processing should generally include standards that require servicers to address major areas of weaknesses highlighted in the review, including in the following general areas:

Governance and Oversight

- implement and routinely audit sound enterprise-wide policies and procedures to govern and control mortgage-servicing and foreclosure processes
- develop quality controls for effective management of third-party vendors who support mortgage-servicing and foreclosure processing
- strengthen the governance standards intended to ensure compliance with applicable federal and state laws and company policies and procedures
- develop company standards that emphasize accuracy and quality in the processing and validation of foreclosure and other servicing-related documents throughout the entire foreclosure process

Organizational Structure, Staffing, and Technology

- increase staffing to adequate levels and provide them with requisite training to effectively manage the volume of default loans and foreclosures
- upgrade information systems and practices to better store, track, and retrieve mortgage-related documents

Accountability and Responsiveness Dealing with Consumers

- ensure borrowers are offered appropriate loss-mitigation options
- ensure proper custody and control of borrower documents related to the servicing of the mortgage
- increase coordination between loss mitigation and foreclosure-processing units to prevent inappropriate foreclosures
- improve communication with borrowers and establish measurable goals and incentives for delivering accurate information and responsive assistance
- develop complaint-resolution processes that are routinely monitored and measured for quality assurance

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STATEMENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

SUBMITTED FOR THE RECORD TO THE

UNITED STATES HOUSE

COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

HEARING REGARDING

MORTGAGE SERVICING: AN EXAMINATION OF THE ROLE OF FEDERAL REGULATORS IN SETTLEMENT NEGOTIATIONS AND THE FUTURE OF MORTGAGE SERVICING STANDARDS

JULY 7, 2011

INTRODUCTION

On behalf of the 1.1 million members of the NATIONAL ASSOCIATION OF REALTORS® (NAR), who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors, and others engaged in all aspects of the real estate industry, thank you for holding this very important hearing on the future of mortgage servicing standards.

A mortgage servicing issue that REALTORS® have a vested interest in is short sales. REALTORS® are invested in this issue because it impacts their business, their clients, and their communities. Over two years ago, NAR came before the full House Financial Services Committee to bring short sale related concerns to the attention of Congress. During that time span, NAR has reached out to both the prior and current Administrations, federal agencies, regulators, Congress and financial institutions about this issue, yet consumers and REALTORS® continue to experience significant failures in this area. So again, we are reaching out to Congress to ensure that consumer concerns regarding this valuable foreclosure mitigation tool are adequately addressed.

The credit crisis has taken a toll on countless thousands of Americans. Many have lost jobs, lost their businesses, and lost their homes. As the number of homeowners experiencing financial difficulties increases due to the prolonged recession, many look for alternative options to foreclosure including selling their homes. A short sale is one instrument at the disposal of homeowners who owe more than their home is worth that will help relieve them of the overwhelming financial burden that their mortgage has become. Due to the nation's continuing economic malaise, the number of short sale properties in the marketplace is extremely high. According to May 2011 data from the National Association of REALTORS®, Nevada, California, Hawaii and Florida are states where significant shares of all properties sold are short sales: 37%, 25%, 25%, and 21%, respectively.

Unfortunately, the ability of the consumer to execute a short sale remains severely hampered by the inability of the lender and/or loan servicer to decide whether to approve a short sale. Too often, short sales are still a story of delay and unrealistic views of current home values, resulting in the potential buyer cancelling the contract and the property going into foreclosure. Enormous amounts of time are spent by distressed homeowners on potential short sales, only to have them result in foreclosures due to obstacles within the cumbersome short sale process.

Homeowners continue to complain that potential homebuyers are walking away from their short sale because the lender has taken many months and still not responded to their request for an approval of a proposed short sale price. Though some efforts have led to modest improvements, many consumers have mentioned that the delay in short sale price approval still exceeds 90 days; in many cases the approval does not arrive prior to the beginning of foreclosure proceedings. While the lending community has worked to improve the size and training of their short sales staffs, improvements in response times have been marginal.

We need lenders to streamline the short sales process in order to reduce the amount of time it takes to sell the property, improve the likelihood the transaction will close, and help reduce the total number of foreclosures. This effort will benefit the lender, the seller, the buyer, and the community.

NAR respectfully requests that as you begin your review of servicing standards that consideration is given to improving the short sales process, especially focusing on issues related to the disposition of second lien positions and the facilitation of negotiations between multiple servicers. Multiple liens divided amongst multiple servicers make the approval process for the sale much more difficult. Second lien holders often hold up the transaction to extract the largest possible payment, in exchange for releasing their lien, even though in foreclosure they will get nothing. Holding the short sale approval process hostage usually ends with this result.

SHORT SALES – A VALUABLE FORECLOSURE MITIGATION TOOL

A short sale is a transaction that occurs when the sales price for a property is insufficient to pay the total of all mortgages, liens and costs of sale, and where the seller cannot bring sufficient liquid assets to the closing to cure all deficiencies. A short sale can occur when an individual is in arrears on a mortgage and headed toward foreclosure. We note, too, that a short sale can also occur when an individual is current on his/her payments but the value of the house has fallen below the outstanding balance on the mortgage. Some home owners who bought at the height of the housing boom may find that they need to sell because of divorce, job transfer or other unforeseen circumstance but find themselves upside down, owing more than the home is currently worth.

A short sale is one tool that can help all of these categories of borrowers. It has particular utility as a mechanism that can be used to avoid a foreclosure. A short sale allows the borrower to sell a property that they can no longer afford. If a borrower can avoid the foreclosure process through a short sale, the consumer is able to rebuild their credit history more quickly and the lender is able to avoid the even higher losses that occur with a foreclosure.

A lender can also benefit from a short sale by avoiding the liabilities it assumes by owning the property after foreclosures. The bank's funds are not tied up while it holds the property after the foreclosure and until resale, and the bank avoids the additional costs associated with a bank-owned property such as attorneys' fees and maintenance expenses. If the bank can avoid foreclosure, then it will not need to accumulate the additional capital reserves it would need if the number of foreclosed properties increases in the bank's portfolio. According to May 2011 data from Lender Process Services (LPS), the average cost of a foreclosure is $60,000 and takes 19.3 months to close. Thus, even though the bank will incur a loss in a short sale, the bank's overall position remains more stable than would occur if it carried out a transaction to foreclosure and ultimate resale of the property. Also, title problems that persist in foreclosure proceedings are avoided in short sales transactions with agreement by all parties on the sale of the home.

In addition, all the parties benefit from a quick sale and a higher short sale price. A short sale provides the added bonus of providing more support for home values in the associated neighborhood than a price derived from the sale of the foreclosed property. Unfortunately, our membership continues to encounter road blocks that are preventing troubled homeowners from utilizing the short sale process. The theme that continues to be mentioned regularly by our members is that lenders take an extraordinary amount of time to decide if they are willing to accept a short sale purchase offer. This "waiting period" can extend 45, 60 or even more than 90 days after submission of an offer and all the requested documentation.

Given these lender delays, too often, the property moves to foreclosure, and eventually the bank finds itself forced to sell it for much less than they could have if they had approved the short sale. This is disastrous for everyone involved – the homeowners, their neighborhoods and communities, and the lender.

CURRENT SHORT SALE ISSUES

REALTORS® have identified two factors that contribute to the problems consumers encounter during the short sale process. The two are: 1) servicer valuations that do not reflect the distressed nature of the sale, and 2) a second mortgage that necessitates two lender/servicer approvals for the sale, and/or the approval of the entity that holds the pool of loans if the mortgage has been securitized.

Unrealistic Servicer Property Valuation

An issue that consumers frequently encounter is that lenders are commonly rejecting legitimate offers. In these situations, the bank's internal property valuations come in much higher than the proposed short sales prices. In many cases, the servicer's valuation system has not taken into account that the sale is a duress sale, that there may be many foreclosed homes in the neighborhood and/or that the property is often times in poor or less than optimal condition.

Second Trust Holders

Consumers with junior trust obligations (e.g., second mortgages or home equity lines of credit) are being hampered in their quest for a quick resolution to their financial burden because the borrower or the first mortgage lender must negotiate with the holder of the second trust to approve the short sale. In most instances, NAR is being informed that junior trust holders are unwillingly to accept the first lender's proposed settlement to facilitate the short sale. Extended negotiations between the first and junior trust holders increases the time required to sell the home, which often forces the potential homebuyer to search for another, non-short sale, property.

Actions like this are leading our members to ask, "If I have a seller who needs to sell their home and a qualified buyer that wants to make the purchase, why does it take so long for the lender to review the information and make a decision? Why does the lender counter these offers with unrealistic requests only to lose the buyer and eventually have to resort to an expensive foreclosure proceeding and an even less lucrative foreclosure sale? Why don't the lenders, who made the loans that put the borrower in this tenuous position initially, want to resolve these negative issues that are in their books in a timely manner?"

By thwarting the short sale, the lender sets off a negative cascade effect that hurts everyone from the borrower, who loses the property and has damaged his / her credit report; the lender, who loses money by bearing the expense of foreclosing on and then reselling the property well below the offered short sale price; the neighborhood, where home values recede due to the artificially low sales price of the foreclosed property; and the community, where the property tax base and collections suffer.

NAR'S EFFORTS TO ADDRESS MEMBER CONCERNS WITH SHORT SALES

In support of our members calls for assistance, NAR has worked on several fronts to help resolve issues encountered during the short sales process. In 2008, NAR established a Short

Sale Working Group composed of REALTORS® from across the country to examine what was occurring in the marketplace, why it is occurring, and what NAR could do to address these issues.

The Working Group's findings led NAR to recognize that there was a need to educate REALTORS® about the short sale process. As a result, NAR has designed a number of materials to help our members understand the key components of the short sale process and how to work with clients in these situations. In addition, NAR has worked with a few of the large financial institutions, as well as Fannie Mae and Freddie Mac, to develop short sales tools focused on real estate professionals to help them better serve consumers as they pursue short sales.

Also, NAR is continuing our outreach to the real estate finance industry to:

- Make contact information for lender/servicer loss mitigation personnel easily available to borrowers. Troubled borrowers need to be able to easily locate, online, the correct department and the individual who will be responsible for processing the short sale application.

- Garner commitments by lenders and their servicers to keep the listing agent and seller regularly informed of the status of the short sale application throughout the process and respond to reasonable requests for information, and

- Obtain a commitment by lenders and their servicers to deliver a clear answer, in writing (yes or no), within a reasonable time frame (i.e. 45 days).

CONCLUSION

Our efforts alone, though many and beneficial, are limited in their impact. In order to ensure that distressed homeowners have access to all of the foreclosure mitigation tools possible, short sales must be viewed as a positive, viable option by all parties.

NAR thanks you for this opportunity to share our thoughts on improving the short sale process as part of reforming mortgage servicing standards. As always, the National Association of REALTORS® is at the call of Congress, and our industry partners, to help continue the housing and national economic recovery.

Microsoft Outlook

From: Warren, Elizabeth (CFPB)
Sent: Monday, March 14, 2011 8:11 AM
To: richard.davis@usbank.com; Date, Rajeev (CFPB)
Cc: richard.hartnack@usbank.com; VALERIE.GROVE@usbank.com
Subject: RE: Follow-up

Thank you, Richard. I always appreciate hearing your thoughtful ideas.

Raj will follow up with Rick, Bryan and Bob.

From: richard.davis@usbank.com [richard.davis@usbank.com]
Sent: Sunday, March 13, 2011 5:05 PM
To: Warren, Elizabeth (CFPB); Date, Rajeev (CFPB)
Cc: richard.hartnack@usbank.com; VALERIE.GROVE@usbank.com
Subject: Follow-up

Elizabeth and Raj - following my conversations on Friday (with each of you), Rich Hartnack and I thought it may be helpful to send you our additional thoughts following our very productive meeting on Thursday. Particularly as it pertains to the "needs test" that we described, here are our
recommendations:

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The "needs test" would encompass the following:

1. Substantial diminishment of income due to economic or unavoidable personal circumstances. This would include:
Unemployment or substantially reduced employment income since the time the mortgage was granted Death or disability Divorce (although we don't want people divorcing in the future to qualify) Medical situation Other unforeseeable circumstance.

2. There are also some situations remaining (most have been worked through at Downey, but Countrywide, World and Wamu might not be as far
along) where the original mortgage was extremely large for the income the family had. In other words, a very poorly structured mortgage that could not be serviced even without loss of income. In these cases the "need"
was created by the original underwriting and as we have done at Downey and OneWest has done with IndyMac, these mortgages need to be restructured.
The limit to the restructure should be the same as we have been using.
Compare foreclosure cost and losses to the modification lost and pick the solution that optimizes the investor's position.

3. What DEFINITELY DOES NOT meet the needs test are the following type of cases:
Voluntary and avoidable diminishment of income (quitting or retiring in order to qualify for a debt reduction windfall) Voluntary reduction of income previously earned (second job, second family income, etc.) Adding obligations since the original mortgage that diminish capacity to pay all obligations simply because they went out and took on more debt.
Bankruptcy without cramdown is the best solution in these cases--and they will be able to keep their house and their mortgage. Major obligations incurred as a result of a medical situation would be accommodated in a "needs test", but these situations are very unique in every case and sometimes bankruptcy is the best solution.
Diminishment of income that is minor and doesn't substantially impact ability to pay if the debtor makes reasonable accommodations.

4. Finally, if the family has additional resources (savings, liquid wealth or real estate investments with positive equity) (but not including 401K, pension, IRA, college savings funds) it would be expected that they would use those resources before getting a principle

write down.

5. Needs test would only be used in primary residence modification. Non-owner occupied property should not be subject to this approach.

The actual program specifications of exactly how the calculations are made on NPV (what discount rate?--it really matters) and property valuation should be reasonable from the perspective of the mortgage debt investor and not obviously stacked against them. Borrowers should pay for any "appeal" appraisals as we have seen these arguments over value go on endlessly.

With all these caveats, we can put in place a mechanism to take care of those that need and deserve it. Keep the system FAIR, and limit damage to what investors implicitly accepted when they bought mortgage debt.

- - - - -

Also know that we have additional thoughts to share regarding the ideas we discussed pertaining to the collateral value issues and if you continue on that path - we would be pleased to share our strong negative reaction to that approach and offer our rationale. Just let us know and we hope this is helpful to you.

Richard and Rick

Microsoft Outlook

From: richard.davis@usbank.com
Sent: Thursday, March 10, 2011 6:44 AM
To: Warren, Elizabeth (CFPB)
Subject: Today

Elizabeth - my team is looking forward to our meeting today and thank you for the invitation.

I wanted you to know that we plan to follow your request and provide a "primer" on how mortgage servicing is conducted and who is impacted. We are honored that we can provide our expertise to your team and I am hopeful that our information will be helpful. Let me also suggest that we "have more information than we will have time" - - so we will move swiftly through the tutorial and fully expect follow-up subsequent to our meeting today.

I am bringing Rick Hartnack, head of Consumer and Small Business Banking for US Bank, Dan Arrigoni, head of US Bank Home Mortgage (and a national mortgage leader), and Bob Smiley, head of US Bank Mortgage Servicing. I trust we will have a very productive meeting.

See you at 11:45!

Richard
U.S. BANCORP made the following annotations

Microsoft Outlook

From: Warren, Elizabeth (CFPB)
Sent: Thursday, March 10, 2011 10:01 PM
To: richard.davis@usbank.com
Subject: RE: Today

Richard,

I'm sorry I didn't see this until now (I'm just now finding a few minutes to open my computer). But you give me a chance to thank you for the very thoughtful and informative meeting. I really appreciate your taking your time to prepare a thoughtful and informative deck, and to bring such knowledgeable people to help us. Rick, Bob and Dan are terrific. You all gave us a great deal to think about, and we are all appreciative.

I value your help--and your friendship--more than you know.

ew

From: richard.davis@usbank.com [richard.davis@usbank.com]
Sent: Thursday, March 10, 2011 6:43 AM
To: Warren, Elizabeth (CFPB)
Subject: Today

Elizabeth - my team is looking forward to our meeting today and thank you for the invitation.

I wanted you to know that we plan to follow your request and provide a "primer" on how mortgage servicing is conducted and who is impacted. We are honored that we can provide our expertise to your team and I am hopeful that our information will be helpful. Let me also suggest that we "have more information than we will have time" - - so we will move swiftly through the tutorial and fully expect follow-up subsequent to our meeting today.

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See you at 11:45!

Richard
U.S. BANCORP made the following annotations

Microsoft Outlook

From: Mudick, Stephanie B [stephanie.b.mudick@jpmchase.com]
Sent: Thursday, February 24, 2011 12:58 PM
To: Date, Rajeev (CFPB)
Subject: RE: monday agenda

Raj - thanks for the note. Just left message for you at office - call at your convenience and we can discuss. [redacted]. Stephanie

From: Rajeev.Date@treasury.gov [mailto:Rajeev.Date@treasury.gov]
Sent: Thursday, February 24, 2011 11:31 AM
To: Mudick, Stephanie B
Subject: monday agenda

Stephanie,

I'm looking forward to Monday.

Just to be clear, though, I'm thinking of the meeting as taking Charlie Scharf up on his offer to learn more about the servicing business, its economics, operational constraints, and your thoughts on servicing standards.

Given persistent rumors and headlines, I do not want this meeting to be construed as relating to any potential settlement discussions or regulatory enforcement actions. And I think the meeting really has to be off the record.

Does that sound right to you? If the timing is awkward given anything else in motion, just let me know and we can postpone.

R.D.

Raj Date
Associate Director -- Research, Markets & Regulations Consumer Financial Protection Bureau
raj.date@do.treas.gov
[redacted]

Microsoft Outlook

From: Date, Rajeev (CFPB)

Sent: Thursday, February 24, 2011 11:31 AM

To: stephanie.b.mudick@jpmchase.com

Subject: monday agenda

Stephanie,

I'm looking forward to Monday.

Just to be clear, though, I'm thinking of the meeting as taking Charlie Scharf up on his offer to learn more about the servicing business, its economics, operational constraints, and your thoughts on servicing standards.

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R.D.

Raj Date
Associate Director – Research, Markets & Regulations
Consumer Financial Protection Bureau
raj.date@do.treas.gov
[redacted]

Microsoft Outlook

From: Date, Rajeev (CFPB)
Sent: Friday, February 11, 2011 4:26 PM
To: stephanie.b.mudick@jpmchase.com
Subject: feb 28th re servicing

Stephanie,

I think you had mentioned Feb 28th might work to connect regarding mortgage servicing.

Does that still work?

R.D.

Raj Date
raj.date@do.treas.gov
[redacted] (office)

Microsoft Outlook

From: john.g.stumpf@wellsfargo.com
Sent: Friday, February 25, 2011 11:59 AM
To: Warren, Elizabeth (CFPB)
Subject: Mortgage

Would you be interested in discussing what the press is reporting on speculated terms and conditions to settle the mortgage servicing issues? I am concerned that it will actually make things worse, not better, if what I'm reading is close to what actually is being considered.

Thanks,

J

Microsoft Outlook

From: Warren, Elizabeth (CFPB)
Sent: Friday, February 25, 2011 6:35 PM
To: 'john.g.stumpf@wellsfargo.com'
Subject: RE: Mortgage

John,

I apologize for not getting back to you earlier. I've been in meetings all day and off email. My personal cell is [redacted], and I'll have it with me all week-end.

ew

-----Original Message-----
From: john.g.stumpf@wellsfargo.com [mailto:john.g.stumpf@wellsfargo.com]
Sent: Friday, February 25, 2011 11:59 AM
To: Warren, Elizabeth (CFPB)
Subject: Mortgage

Would you be interested in discussing what the press is reporting on speculated terms and conditions to settle the mortgage servicing issues? I am concerned that it will actually make things worse, not better, if what I'm reading is close to what actually is being considered.

Thanks,

J

Overview of the Mortgage Servicing Industry

Thursday, March 10, 2011

All of us serving you℠

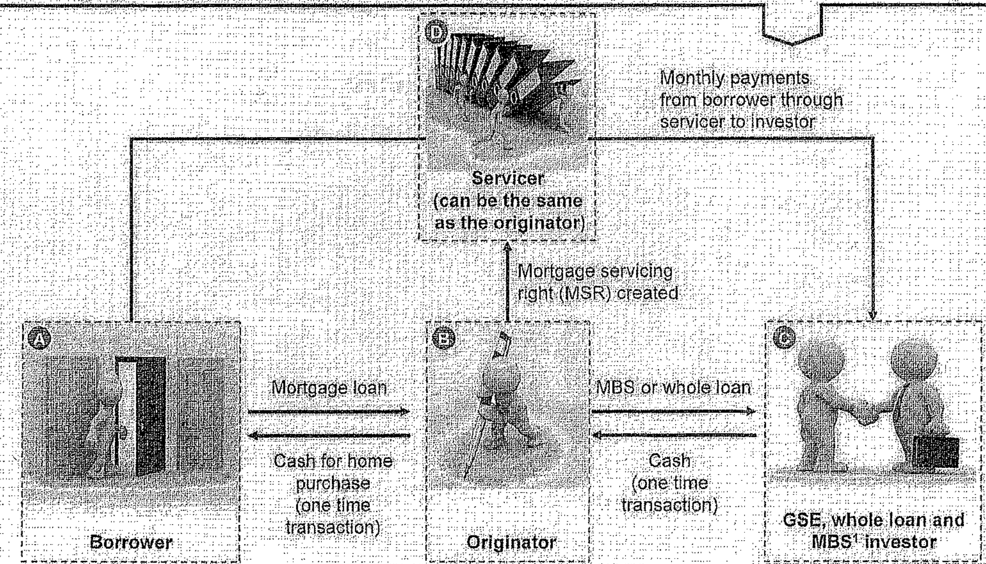
usbank.

UST-CFPB-1 000273

Today's objectives

- Level set on the mortgage industry overall and each step in the mortgage value chain: origination, investing, and servicing
- Focus on the key elements of mortgage servicing

Mortgage business system



1 MBS = Mortgage Backed Security (securitization of package of mortgage loans); Originator may hold loan on own balance sheet rather than selling loan to investors (called selling to the secondary markets)

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5 key drivers impact the size of the mortgage market

Size of Mortgage Market (Volumes)

Long term growth of 3-5% expected

Drivers	10 year outlook	Rationale
Housing stock	↑ • Flat for 2-3 years • 1-2% growth in longer term	• 2-3 years for demand to absorb current shadow inventory • Long term trend in line with population growth and new household formation
Home ownership rates	↓ • 64-66% (below peak of ~68%)	• Reversal of pre-crisis credit-driven trends driven by deleveraging of household balance sheets • Baby boomers will be exiting housing market
Homes with mortgages	↓ • Slightly below current level of 70%	• Demographic shifts (aging populations) imply greater percentage of homeowners will have paid off their mortgages • Deleveraging increases propensity of homeowners to pay off mortgages
Loan-to-value ratios	↓ • Flat or slight decline from current rate of ~70%	• Reduced willingness by households to take on leverage • Banks maintain tight lending standards • Home price appreciation likely to be muted (see below)
House prices	↓ • Decline over the next 1-2 yrs ↑ • Long term growth in line with nominal GDP (~3-4%)	• Declines driven by supply-demand imbalance and weakness in economy • Fundamental demand is driven by increase in incomes • Leverage-fueled housing boom unlikely because of tighter credit conditions

SOURCE: Mortgage Banker Association, FHFA, US Census Bureau, Expert Interviews

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Mortgage value chain

	1 Origination: Borrowers	Point-of-sale originators (e.g., brokers, banks)	Aggregators	2 Investing: Credit enhancers	Structurers (issuers and underwriters)	Investors	3 Servicing
Activities		▪ Guides borrowers through lending process ▪ Acts as inter-face with borrowers for internal originators or on behalf of third-party originators ▪ Correspondents capable of funding themselves	▪ Provides broker and retail channel with requisite capital to close loans in the form of table funding and warehouse financing ▪ Sells loans to structurers and servicing rights to servicers	▪ Ensures adequate underwriting standards ▪ Provides credit enhancement and insurance for the investors	▪ Buys loans from principal originators ▪ Issues and underwrites mortgage pools to sell investors ▪ Keeps some loans (as MBS or whole-loans) on portfolios ▪ Manages risk or markets securitization residuals	▪ Individual and institutional investors ▪ Purchases MBS as investments and trades with other investors	▪ Protects investors' interests through maintaining effective loan admini-stration ▪ Interacts with borrowers on as-needed basis
Example players		▪ Small regional banks (correspondent) ▪ Credit unions ▪ Major banks ▪ Independent brokers	▪ GSEs ▪ Major banks	▪ GSEs ▪ FHA ▪ Private mortgage insurers	▪ Broker dealers	▪ Insurance companies ▪ Pension funds ▪ Central bank ▪ Banks ▪ Mutual funds	▪ Major banks ▪ Special servicers (small)

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❶ Origination

Mortgage origination process

Application	Open file	Processing	Underwriting	Pre-closing	Closing
▪ Buyer becomes borrower ▪ Employ-ment information ▪ Financial debts / DTI ▪ Residency information ▪ Receive truth-in-lending and good faith estimate	▪ Lender orders property appraisal and credit report ▪ Lender mails verifi-cation of employment (VOE) and deposit (VOD) ▪ Wait to receive VOE and VOD	▪ Credit report reviewed ▪ Debt and payment history verified ▪ Appraisal reviewed	▪ Lender underwriting ▪ Must conform to underwriting standards of investors ▪ Significant premium put on quality control	▪ Title insurance ordered ▪ Approval conditions met ▪ Closing schedule by title company ▪ Borrower orders home owner's insurance	▪ Borrower obtains loan proceeds ▪ Borrower presents balance of down payment and closing costs ▪ Loan closes ▪ Borrower moves in

Quality of loan underwriting is the biggest single determinant of servicing cost over life of the loan

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1 Origination

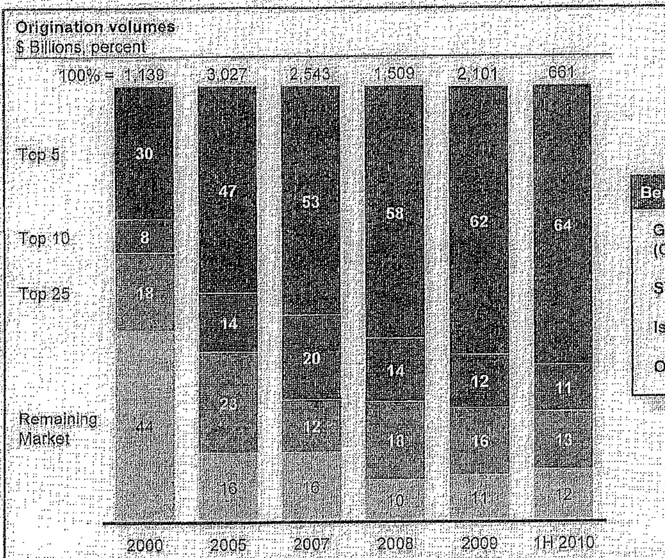
Types of mortgage originators and origination channels

✓ Primary channel
✓ Secondary channel

Types of originators	Description	Channels: Phone / internet	Bank branch	Realtor
Independent mortgage brokers	▪ Sell originations upstream to major banks ▪ Typically lack balance sheet capacity to own loans and don't have any servicing capabilities	✓ (Secondary channel)		✓ (Primary channel)
Major banks	▪ Originate, close and service loans ▪ Either hold the loans (non-conforming) on their balance sheet or sell loans to GSEs, FHA, etc	✓ (Primary channel)	✓ (Primary channel) (Refinance)	✓ (Primary channel)
Correspondent banks	▪ Sell 'whole loans' already closed and funded upstream to major banks because they either lack balance sheet capacity to own the loans or the capability to service them ▪ Some sell directly to the GSEs, FHA, etc	✓ (Secondary channel)	✓ (Primary channel)	✓ (Primary channel)

1 Origination

Significant consolidation in wholesale aggregation in the past 10 years, driven by economies of scale in GSE sales, servicing, and MBS issuing



Benefits of scale with volume	
GSE sales (G-Fee Discounts)	Yes
Servicing Costs	Yes
Issuing MBS	Yes
Origination Costs	No

only for PL
not NPL

SOURCE: Mortgage Market Statistical Annual; Inside Mortgage Finance report; Economy.com; Mortgage Bankers Associations

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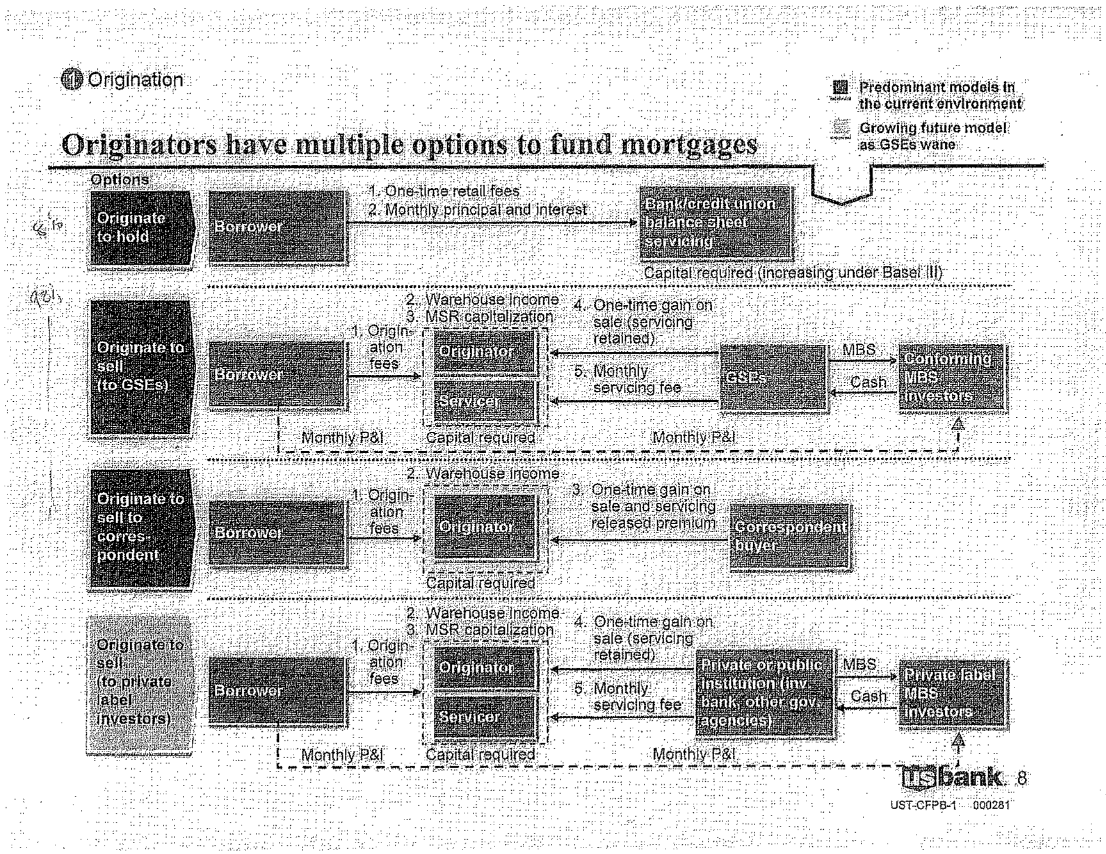
Origination
Originators have multiple options to fund mortgages
Predominant models in the current environment
Growing future model as GSEs wane
Options
Originate to hold
Borrower
1. One-time retail fees
2. Monthly principal and interest
Bank/credit union balance sheet servicing
Capital required (increasing under Basel III)
Originate to sell (to GSEs)
Borrower
1. Origin-ation fees
2. Warehouse income
3. MSR capitalization
Originator
Servicer
4. One-time gain on sale (servicing retained)
5. Monthly servicing fee
GSEs
MBS
Cash
Conforming MBS investors
Monthly P&I
Capital required
Monthly P&I
Originate to sell to corres-pondent
Borrower
1. Origin-ation fees
2. Warehouse income
Originator
3. One-time gain on sale and servicing released premium
Correspondent buyer
Capital required
Originate to sell (to private label investors)
Borrower
1. Origin-ation fees
2. Warehouse income
3. MSR capitalization
Originator
Servicer
4. One-time gain on sale (servicing retained)
5. Monthly servicing fee
Private or public institution (inv. bank, other gov. agencies)
MBS
Cash
Private label MBS investors
Monthly P&I
Capital required
Monthly P&I
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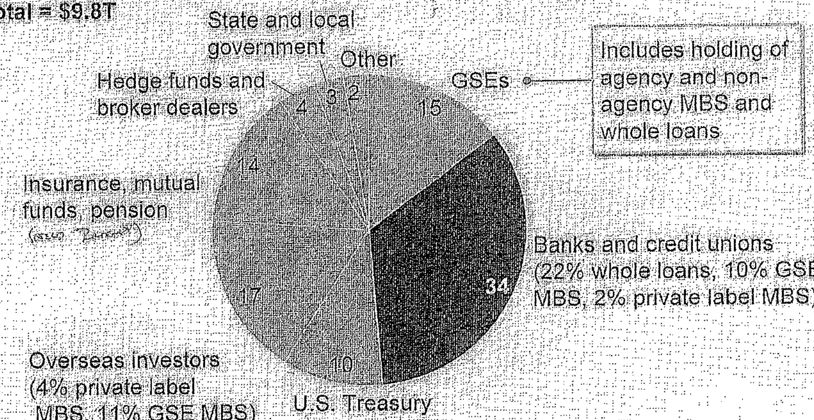
❷ Investing

Banks in the U.S. own only one third of mortgage volume

Shelf space of outstanding volume
Percent of volume, 2009

Total = $9.8T



1 Includes GSE balance sheet
SOURCE: Federal Reserve Flow of Funds

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② Investing

Investors Becoming Active (mostly GSEs)

Key enablers for an efficient mortgage investors market

Efficient mortgage markets assure consumers the lowest possible price

Key enablers	Rationale
Clear and common standards for underwriting, loan servicing, and investor reporting	▪ Investors demand clarity of what they buy ▪ Consistent standards result in greater investor confidence
Efficient primary market	▪ Need an efficient primary market to sell to the investors, and investors are required given the size of the market
Clarity and integrity of investor rights	▪ Predictable investment outcomes increase market efficiency. Losses, prepayment, servicing cost, bankruptcy cramdown, and principal deferral negatively affect predictability
Additional market liquidity through securities markets and secondary market	▪ Need an efficient secondary market to attract investors, and investors are required given the size of the market ▪ Active secondary trading provides greater liquidity & attracts investors
Credit enhancement	▪ Most investors require high quality investment grade bonds, so mortgages need to be credit enhanced by private or public parties ▪ Quality and reputation of originator impact price and market acceptance ▪ Without credit enhancements, bond prices will be higher and will impact consumer pricing

UST-CFPB-1 000283

13 Servicing

Overview of the US mortgage servicing industry

- U.S. mortgage servicing volumes were $9.8 trillion in 2009; in 2010 the growth continued but slowed after double digit growth in last 5+ years (12%+ CAGR in 2001-2007)
- Servicing volume is likely to grow slowly in the next few years, due to lagging origination volumes
- Mortgage servicing is highly consolidated (~60% of total portfolio serviced by the top 5 players) with a fairly long "tail" (next ~20 players each with 0.5 - 2% share)
  - All significant servicers are also originators
  - Landscape of servicing players has changed with increasing consolidation, exit of smaller players, and increasing role of private equity
  - Cost and complexity of servicing is a barrier to entry

③ Servicing

Business-as-usual (BAU) servicing
Default servicing (details follow)

Overview of mortgage servicing operations

Loan setup	Escrow handling	Payment/ payoff processing	Customer handling	Investor services	Default management
▪ Validate loan terms and customer information ▪ Validate and setup tax and insurance records ▪ Send welcome letter to borrower or make welcome call	▪ Tax payments and research ▪ Escrow analysis and overage check disburse-ments ▪ Hazard insurance payments and research	▪ Apply payments; payment reversals & research; process payments for default accounts ▪ Process payoff requests; final escrow account disburseme nt and payoff lien release ▪ IRS reporting	▪ Handle all customer inquiries such as principal balance, next payment due date, ARM explanation, ACH enrollment, escrow explanation etc.	▪ Investor remitting and reconcilia-tion ▪ Payment clearing and disburse-ment clearing ▪ Servicing fee structure	▪ Early collections through telephone, mail and email (contact inducement, door-knocker) ▪ Late stage collections ▪ Loss mitigation through loan modifications ▪ Foreclosure, bankruptcy, and real estate disposition

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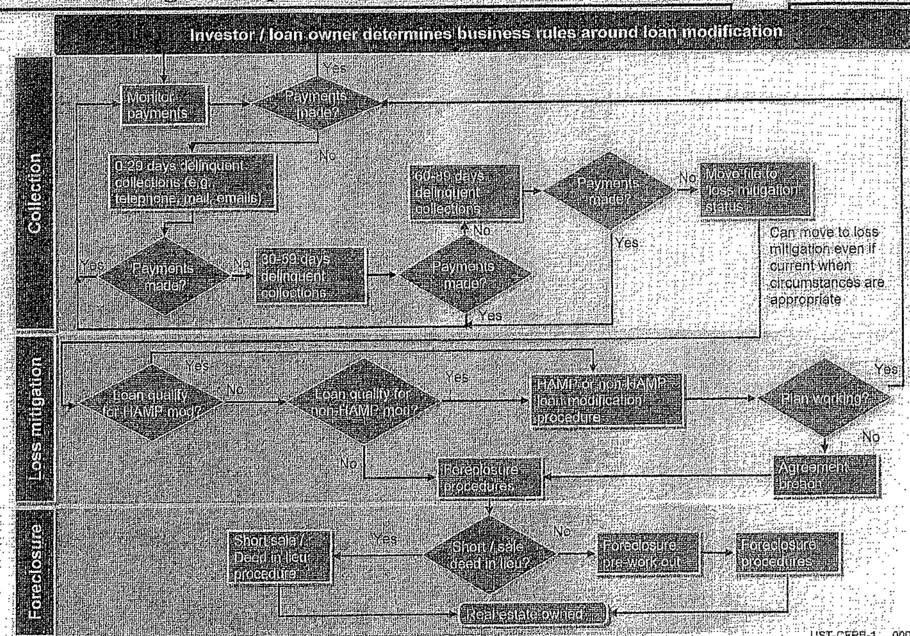
Servicing

Default management process



13

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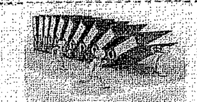
③ Servicing

Default management from borrower, servicer, and investor perspective

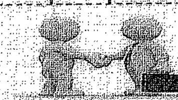
Borrower perspective

- Borrowers, alone or with advisors, make rational choices based on their circumstances
- Value of home relative to debt influences propensity to continue paying mortgage
- Diminished income narrows choices– modify or give up home are only practical choices
- High debt loads can make bankruptcy another path
- Under some circumstances borrowers are unwilling or unable to continue paying (move, divorce, death)
- Borrower behavior ranges from cooperative to purposeful stalling techniques



Servicer perspective

- Modification only works with borrowers that have both capacity and willingness to pay modified loan
- Foreclosure is almost always the most costly path to follow
- Servicing for a multitude of investors means two similarly situated borrowers may get very different treatment
- Short sale– essentially a one bidder auction for a home– is most problematic resolution
- Programs like HAMP are well designed for some borrowers but not necessarily all
- FHA short refinance program is not widely used



Investor perspective (GSE, whole loan, and MBS)

- Foreclosure involves high cost, unpredictable outcomes, and introduces a wide variety of operational risk and expense
- Whole loan owners– primarily banks– generally do everything possible to keep borrowers in house
- GSEs have very tight business rules for handling defaults and modification
- Investors exhibit wide spectrum of approaches to default management– from prohibition of interest or principal mod. to more flexible approaches
- Poor underwriting and structure lead to greater losses

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③ Servicing

Customer hardship helps determine the most appropriate modification

What are the options available to treat a delinquent mortgage customer who is willing and able to pay?

Options available

Short-term hardship (primarily income interruption or expense bulge)

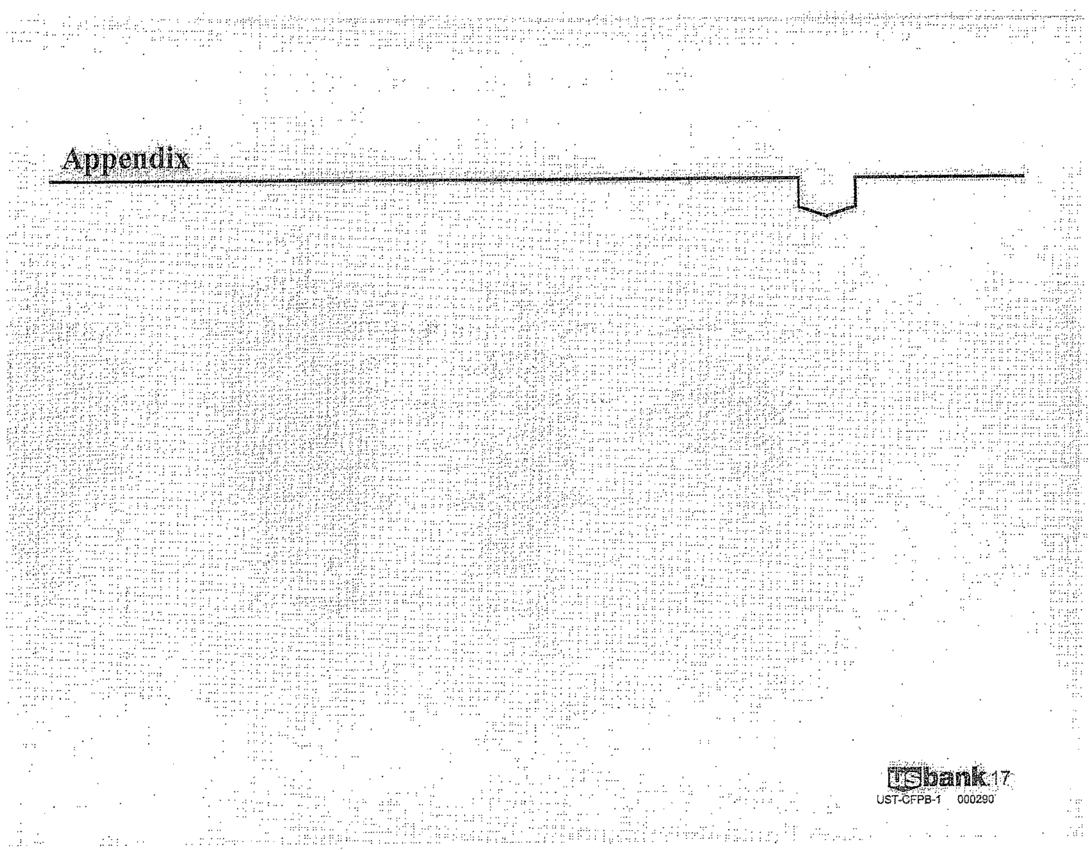
Increasing severity of customer hardship

Significant hardship (loss of job, extended medical expenses)

- **Reinstatement via "payment plan"** Payment of delinquent amount and collection fees
- **Deferment** Partial payment of delinquent amount followed by moving the remaining past due to a future date
- **Modification** Adjustment to APR, term, or capitalization
- **Debt reduction** Partial or total reduction of interest, partial reduction of capital
- **Exit strategies** (e.g., Foreclosure, Deed-in-Lieu, Short Sale). Sale of house to mitigate losses through proceeds

Factors to consider going forward

- Strong investor demand for mortgage debt is critical to an efficient and effective consumer mortgage market
- Need to consider the legal / legislative / regulatory foundation for servicing agreements that give servicers and trustees clear guidance to act to resolve borrower problems without increasing mortgage pricing to consumers excessively
- GSEs play a large and critical role in the mortgage market and great care must be exercised in scaling back or eliminating their role to avoid shocking the market, restricting supply of mortgage finance, or impacting consumer pricing excessively


Appendix
usbank 17
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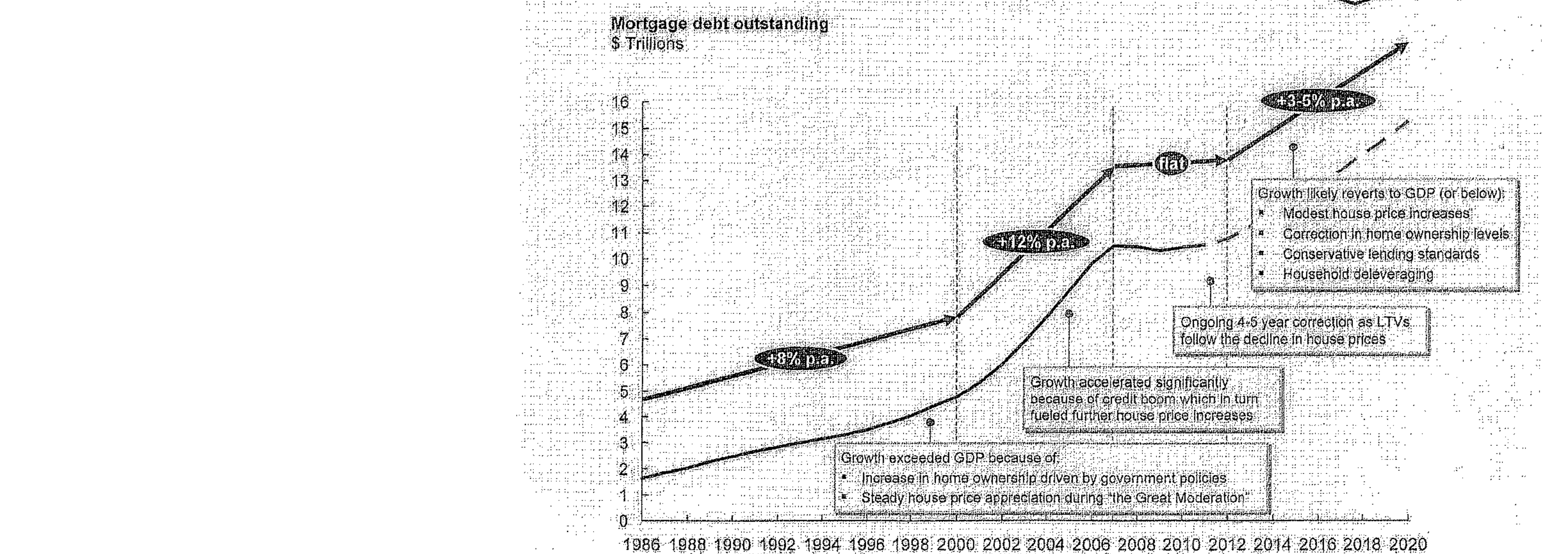
Mortgage industry will likely grow slower than over the past 25 years



SOURCE: Federal Reserve Flow of Funds

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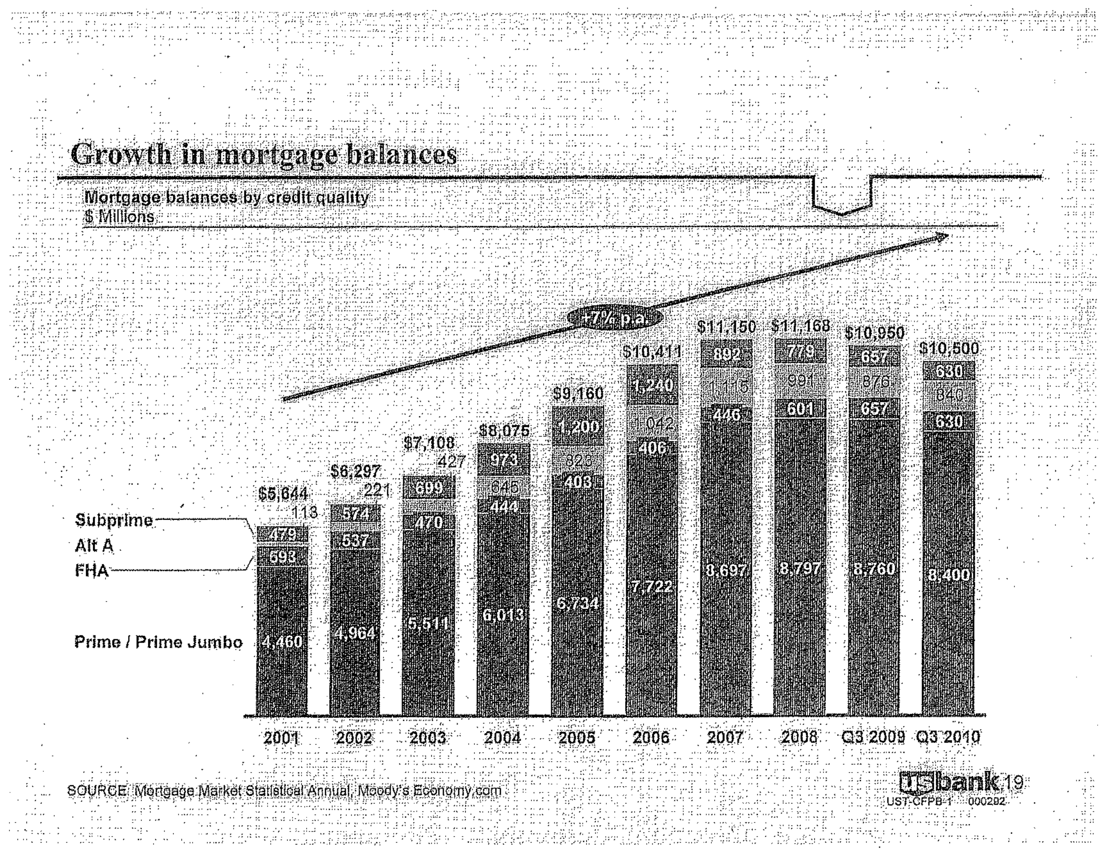
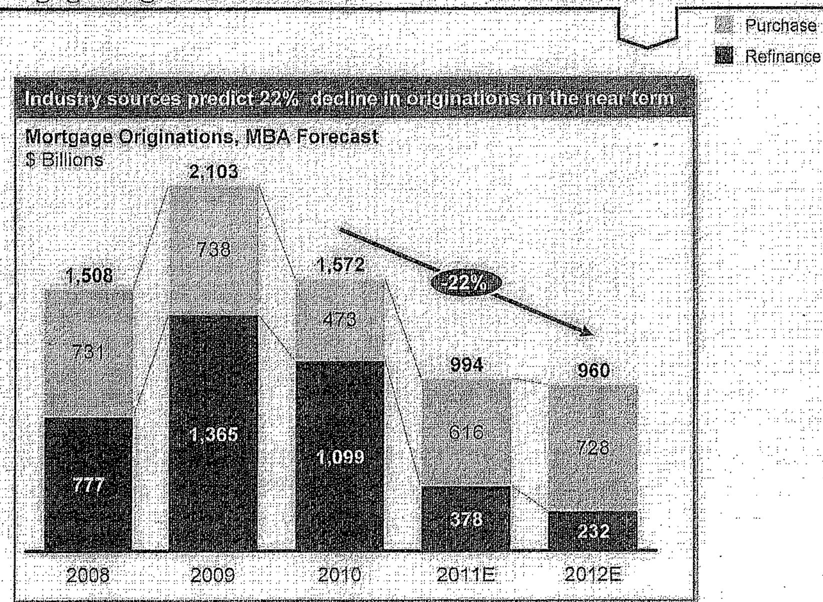

Growth in mortgage balances
Mortgage balances by credit quality
$ Millions
Subprime
Alt A
FHA
Prime / Prime Jumbo
$5,644
$6,297
$7,108
$8,075
$9,160
$10,411
$11,150
$11,168
$10,950
$10,500
2001
2002
2003
2004
2005
2006
2007
2008
Q3 2009
Q3 2010
SOURCE: Mortgage Market Statistical Annual, Moody's Economy.com
19
UST-CFPB-1 000202

Servicing volume is likely to grow slowly in the next few years, due to lagging mortgage origination volumes



SOURCE: Inside Mortgage Finance; MBA forecast; Fannie Mae; Moody's

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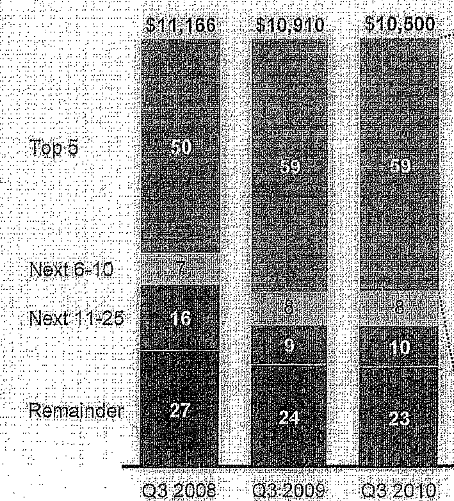
There has been significant consolidation among the mega-servicers

Q3 2010 top mortgage servicers
$ Billions; Percent



Top 5 servicers	Major consolidations
Bank of America	Countrywide Financial Bank of America Mtg. & Affiliates Home Loans Services (Merrill Lynch) Wilshire Credit (Merrill Lynch)
Wells Fargo	Wachovia Corporation
JP Morgan Chase	Chase Home Finance Washington Mutual EMC Mortgage (Bear Stearns)
Citigroup	CitiMortgage Inc.
Ally Financial	

SOURCE: Inside Mortgage Finance, Mortgage Market Statistical Annual

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The servicing market has three different segments

Segment	Name	Market Share Percent	Volume $ Trillions	Origination Services/ Originator	Paper Type
Mega Lenders	Bank of America	19.5%	$2.1	✓	Mostly prime
	Wells Fargo	17.2%	$1.8	✓	Mostly prime
	Chase	11.9%	$1.3	✓	Mostly prime
	CitiMortgage	5.7%	$0.6	✓	Mostly prime
Smaller – mostly prime-focused – lenders	Ally Financial	3.4%	$0.36	✓	Mostly prime
	U.S. Bank	2.1%	$0.22	✓	Mostly prime
	PHH	1.6%	$0.17	✓	Mostly prime
	SunTrust	1.5%	$0.16	✓	Mostly prime
	OneWest Bank	1.3%	$0.14	✓	Mostly prime, Alt A
	PNC	1.3%	$0.14	✓	Mostly prime
	MetLife	1.1%	$0.12	✓	Mostly prime
	HSBC	1.0%	$0.11	✓	50% subprime
	BB&T	.8%	$0.08	✓	Mostly prime
	Fifth Third	.6%	$0.07	✓	Mostly prime
	Flagstar	.6%	$0.06	✓	Mostly prime
	EverBank	.5%	$0.06	✓	NA
	Regions	.5%	$0.05	✓	Mostly prime
Specialty Outsourcer	American Home	.7%	$0.08		>50% subprime, Alt A
	Ocwen	.7%	$0.07	✓	>50% subprime
	Aurora	.6%	$0.07		Mostly Alt A, prime
	Nationstar Mtg.	.6%	$0.06	✓	NA

- Most servicing players focus on the prime market – and are also originators
- Specialist outsourcers, for the most part, focus on the non-prime space and have some originations BPO capabilities

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Definitions

Term	Definition
GSE	**Government Sponsored Enterprise** Group of financial services corporations created by the U.S. Congress to enhance the flow of credit (e.g., Fannie Mae, Freddie Mac)
Modification / forbearance	Process where the terms of a mortgage are modified outside the original terms of the contract agreed to by the lender and borrower
HAMP	**Home Affordable Modification Program** Federal program targeting homeowners at risk of foreclosure to help with loan modifications on their home mortgage debt
Short sell	Sale of real estate where the sale proceeds are less than the balance owed on the property's loan and where both parties consent to the short sale process (in order to avoid foreclosure)
Foreclosure	Legal process by which an owner's right to a property is terminated, usually due to default
REO	**Real Estate Owned** Class of property owned by a lender after an unsuccessful sale at a foreclosure auction
MBS	**Mortgage-Backed Security** Asset-backed security that represents a claim on the cash flows from mortgage loans through securitization
MSR	**Mortgage Servicing Rights** Contractual agreement where the rights to service an existing mortgage are sold by the original lender to another party
Normal servicing	Servicing of mortgages that are neither in default, nor heading towards default (vs. distressed servicing)
Subservicer	3rd party who handles the servicing of mortgages for the borrower, and whose responsibilities often include payment collection and holding escrow for taxes / insurance
Deed-in-lieu	Mutual agreement to have ownership interest transferred to the lender as payment in full in order to avoid lengthy and expensive foreclosure processes
PD	**Probability of Default** Likelihood that a loan will not be repaid and will fall into default – a parameter used in the calculation of economic capital under Basel II
LGD	**Loss Given Default** Loss incurred if a borrower default – a parameter used in the calculation of economic capital under Basel II

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Supplemental Directive 11-06 ***July 6, 2011***

Making Home Affordable Program – Updates to Servicer Incentives

In February 2009, the Obama Administration introduced the Making Home Affordable (MHA) Program to stabilize the housing market and help struggling homeowners get relief and avoid foreclosure. In March 2009, the U.S. Department of the Treasury (Treasury) issued uniform guidance for loan modifications by participants in MHA across the mortgage industry and subsequently updated and expanded that guidance. In June 2011, Treasury issued version 3.2 of the *Making Home Affordable Program Handbook for Servicers of Non-GSE Mortgages (Handbook)*, a consolidated resource for guidance related to the MHA Program for mortgage loans that are not owned or guaranteed by Fannie Mae and Freddie Mac (Non-GSE Mortgages).

This Supplemental Directive provides changes to servicer compensation for completed permanent modifications under the Home Affordable Modification Program (HAMP) and is designed to encourage servicers to provide an appropriate solution, at the very early stages of the delinquency, to borrowers who are suffering a hardship. This Supplemental Directive amends and supersedes the notated portions of the *Handbook*.

This Supplemental Directive is applicable to all permanent HAMP modifications with a trial period plan effective date on or after October 1, 2011 (Supplemental Directive Effective Date). Servicers that are subject to a servicer participation agreement and related documents (SPA) must follow the guidance set forth in this Supplemental Directive. This guidance does not apply to mortgage loans that are owned or guaranteed by Fannie Mae or Freddie Mac, insured or guaranteed by the Veterans Administration or the Department of Agriculture's Rural Housing Service or insured by the Federal Housing Administration (FHA).

Servicer Incentives for Completed Modifications

For all HAMP permanent modifications with a trial period plan effective date on or after the Supplemental Directive Effective Date, servicers will be entitled to receive completed modification incentives on a sliding scale, based on the number of days the mortgage loan is delinquent as of the effective date of the trial period plan. The new scale for servicer completed modification incentives is as follows:

No. of days delinquent at Trial Period Plan Effective Date	Incentive Amount
Less than or equal to 120 days delinquent (150 days from last full paid installment (LPI) date)	$1,600
121 days or more delinquent to and including 210 days delinquent (151 to 240 days from LPI date)	$1,200
Greater than 210 days delinquent (greater than 240 days from LPI date)	$400

For permanent HAMP modifications with trial period plan effective dates on or after the Supplemental Directive Effective Date, the additional $500 compensation payable to the servicer if a borrower was current under the original mortgage loan is eliminated.

Servicer Pay-for-Success incentives and all borrower and investor incentives remain unchanged.

Prohibition Against Special Collection Measures

Following a servicer's standard collection efforts and during consideration of a borrower for HAMP, servicers may not take additional collection measures for the purpose of reducing the delinquency period in order to qualify for a higher up-front servicer incentive. These additional efforts include but are not limited to, requesting or requiring borrowers to make past due payments, bringing a loan less delinquent through capitalization, or deferral or forgiveness of payments. MHA-Compliance will perform testing of loan payment histories to ensure that such activities do not occur.

Reporting

Updated HAMP payment processes implementing the terms of this Supplemental Directive are currently under development by the Program Administrator. Subsequent guidance on such processes will be provided on www.HMPadmin.com. Servicers with completed permanent HAMP modifications having trial period plan effective dates on or after the Supplemental Directive Effective Date should continue to report their HAMP modified loans. Until the payment processes implementing the terms of this Supplemental Directive are in place, servicers will receive compensation under the existing compensation matrix. Upon implementation of such payment processes, the Program Administrator will make a one time adjustment payment to the servicers to "true-up" the completed modification incentive payment for completed modifications with trial period plan effective dates on or after the Supplemental Directive Effective Date. This adjustment may result in an additional payment of incentives earned for loans modified early in the delinquency or a recapture of excess incentive payment made for loans modified late in the delinquency.

Transfer of Servicing

In the event the servicing of a loan subject to this incentive change is transferred prior to implementation of the updated HAMP payment processes implementing the terms of this Supplemental Directive, any adjustment to incentives will be paid to or recaptured from the servicer of record as of the date of the implementation.

EXHIBIT A
MHA HANDBOOK MAPPING

The following guidance amends and supersedes the notated portions of the *Handbook.* Changed or new text is indicated in italics. Text that has been lined out has been deleted.

A. The list of bulleted items in Section 2.2 of Chapter I is amended to add the following text as the final bullet:

- *Information relating to the borrower's payment history.*

B. Sections 13.1, 13.1.1 and 13.1.2 of Chapter II are replaced in their entirety with the following text:

13.1 Servicer Incentive Compensation

A servicer will be entitled to the completed modification incentive ~~and, if applicable, the current borrower incentive~~ once the borrower enters into a permanent modification, provided that the servicer has reported to the Program Administrator any required servicer or loan set up data. The completed modification incentive ~~and the current borrower incentive~~ will be paid to the servicer in the month that the permanent modification becomes effective.

13.1.1 Completed Modification Incentive

A servicer will receive compensation *in accordance with the following chart* ~~of $1,000~~ for each completed modification under HAMP.

No. of days delinquent at TPP Effective Date	*Incentive Amount*
Less than or equal to 120 days delinquent (150 days from last full paid installment (LPI) date)	*$1,600*
121 days or more delinquent to and including 210 days delinquent (151 to 240 days from LPI date)	*$1,200*
Greater than 210 days delinquent (greater than 240 days from LPI date)	*$400*

13.1.2 ~~Current Borrower Incentive~~ *Prohibition on Special Collection Measures*

~~If a borrower was current under the original mortgage loan, a servicer will receive an additional compensation amount of $500 for completing the permanent modification. Pursuant to Section 8.2, when the TPP Notice is transmitted to the borrower after the 15th day of a calendar month, which calls for a TPP Effective Date as of the first day of the month after the next month, such incentive is paid only if borrowers either (i) make their contractual payment in the intervening month prior to the effective date of the trial period; or (ii) agree to commence their trial period on~~

~~the first day of next month. Servicers should remind their current borrowers in writing that they must make all contractual payments due under the terms of their original loan documents until the TPP Effective Date.~~

Following a servicer's standard collection efforts and during consideration of a borrower for HAMP, servicers may not take additional collection measures for the purpose of reducing the delinquency period in order to qualify for a higher up-front servicer incentive. These additional efforts include but are not limited to, requesting or requiring borrowers to make past due payments, bringing a loan less delinquent through capitalization, or deferral or forgiveness of payments. MHA-C will perform testing of loan payment histories to ensure that such activities do not occur.

Response of Michael Calhoun

Congressman Joe Baca
Financial Institutions and Consumer Credit & Oversight and Investigations Subcommittees Joint Hearing – *Mortgage Servicing: An Examination of the Role of Federal Regulators in Settlement Negotiations and the Future of Mortgage Servicing Standards*
Questions for the Record
July 7, 2011

Questions for David Stevens, President, Mortgage Bankers Association & Michael Calhoun, Center for Responsible Lending

1) How many commercial loans that are currently being serviced by special servicers will find themselves in some sort of trouble in the next 3-5 years? What is your estimate as to how many loans will get modified vs. foreclosed in that time period?

2) Can you assess the impact that the commercial real estate market has had on our economy, specifically our nation's unemployment? What impact do you think a series of mass foreclosures in the commercial real estate market would have on our economy?

1. According to an industry analytics firm, Trepp, and Fitch ratings , CMBS is continuing to default at elevated rates with over $1.3 billion in commercial mortgage-backed securities resolved with losses in July and the default rate approaching 13% on these securities. CRL does not focus on the general performance of the commercial loan market and cannot give a reliable estimate of expected modifications and defaults, but clearly it is a segment that bears close monitoring.

2. The residential construction market is at post World War II lows in level of activity, and the commercial construction market is likewise severely depressed. Both of these are a substantial current drag on the overall economy. Further foreclosures in both markets will only depress markets, property values and construction levels even lower.

Questions for Raj Date from
The Subcommittee on Financial Institutions
Committee on Financial Services, U.S. House of Representatives

Hearing held on July 7, 2011, entitled
"Mortgage Servicing: An Examination of the Role of Federal Regulators in Settlement Negotiations and the Future of the Mortgage Servicing Standards"

Questions from Rep. Joe Baca

1) What is the approximate size of the commercial securitized loans in the country and how do they compare to the residential loans? Moreover, what percentages of commercial loans are currently going through or have gone through special servicers?

According to the Royal Bank of Scotland Commercial Mortgage Backed Securities Credit Monitor (as of August 2, 2011), there are just under $600 billion in commercial mortgage backed securities outstanding, and 12.7% of loans are with special servicers. In comparison, commercial mortgage backed securities are about half the size of private-label residential mortgage backed securities, which outstanding is approximately $1.2 trillion.

2) Can you comment on the CFPB's current efforts or future plans to monitor the commercial real estate market? Has there been any consideration regarding programs that can be created to help deal with problems being encountered with commercial real estate modifications?

The CFPB's statutory objectives and authorities focus on financial products and services meant for consumers—our enabling legislation mandates that focus. The Bureau does not have jurisdiction over commercial credit (including the commercial real estate market and commercial real estate modifications) except in limited cases where Congress has explicitly and affirmatively granted the Bureau such jurisdiction. The main exception is the Bureau's authority to prevent discrimination in business lending: the Equal Credit Opportunity Act (ECOA) prohibits lenders from discriminating in the provision of business (as well as consumer) credit on the basis of race, national origin, sex, or other protected classes.

<u>Question from Rep. Blaine Luetkemeyer</u>

1) In your testimony before the Subcommittees, you discussed the many stakeholders the Consumer Financial Protection Bureau (CFPB) has worked with on the mortgage servicing issues, including many academics. Please provide a list of all stakeholders who have met with CFPB on the issue of mortgage servicing, including representatives from academia, private industry, and the not-for-profit sector, along with the institutions they represented.

As is apparent from Professor Warren's calendar which has been made publicly available, a copy of which is attached, the Consumer Financial Protection Bureau (CFPB) meets with a wide range of stakeholders on many issues relevant to the CFPB's scope of work. Because of the importance of the issue of mortgage servicing currently, the issue regularly arises in meetings with banks, with consumer and community groups, and with academics. As a result, it is not possible to list everyone with whom anyone from the Bureau has met over the past year who has discussed mortgage servicing.

Questions for Julie Williams, First Senior Deputy Comptroller and Chief Counsel, Office of the Comptroller of the Currency

1) A lot of attention has been paid to the ongoing crisis that is occurring in the residential marketplace and rightfully so. The strength of our housing market is a key component in the overall strength of this nation's economy. Unfortunately, we continue to experience similar turmoil in the commercial market as well.

   In April of this year, the OCC issued a report titled, "Interagency Review of Foreclosure Practices." This report was focused on the foreclosure practices in the residential marketplace, but given the problems found, it would not be unreasonable to conclude that similar problems may exist when it comes to commercial foreclosures.

   Have you looked at the problems that exist in the commercial mortgage industry, specifically those related to the Special Servicing Industry? And can you comment on implementing a similar review and reform program for commercial mortgages?

   OCC examiners are monitoring conditions in the commercial mortgage markets and the workout and foreclosure practices for such loans at national banks with significant volumes of these products. However, because of fundamental differences in the commercial and residential mortgage markets, we do not believe the pervasive problems that were found in the residential mortgage markets exist in the commercial mortgage markets. First, the commercial mortgage markets did not experience the same level of increase in activity as occurred in the residential mortgage markets. Thus, the operational infrastructure supporting the commercial mortgage market has not been as strained as has been the case for residential mortgages. Second, because commercial mortgages are typically large dollar, customized transactions with attributes or terms unique to each loan, each loan or transaction is more specialized and handled individually, as opposed to pools of residential mortgage loans. We will continue to monitor this segment of the mortgage market and are prepared to take corrective action if and when we see weaknesses.

2) **In 2009, the National Consumer Law Center issued a report that stated servicers found it cheaper to foreclose rather than offer mortgage modifications. This behavior was prevalent in the residential market, and I am concerned it has found its way into the commercial market. Can you comment on whether you have seen this type of behavior as well?**

   The decision of whether to modify a loan or foreclose is very fact specific and based on a number of factors, including the characteristics of the borrower, the underlying properties or projects, and investors. In general, banks tend to view foreclosure as the last option that is pursued only after they have attempted other potential remedies. If an underlying project is viable, it is generally in the bank's best interest to not foreclose, since foreclosure would require them to incur the additional expense of managing or marketing a property. Because banks evaluate the credit risk of a commercial mortgage on a periodic basis, banks are typically aware of weaknesses in the credit before an actual default occurs. This typically provides additional time and options for a successful workout strategy.

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